
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2017

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file numbers: 001-34465 and 001-31441

SELECT MEDICAL HOLDINGS CORPORATION
SELECT MEDICAL CORPORATION

(Exact name of Registrant as specified in its Charter)

Delaware Delaware (State or Other Jurisdiction of Incorporation or Organization)	20-1764048 23-2872718 (I.R.S. Employer Identification Number)
4714 Gettysburg Road, P.O. Box 2034 Mechanicsburg, PA 17055 (Address of Principal Executive Offices and Zip code)	

(717) 972-1100

(Registrants' telephone number, including area code)

Indicate by check mark whether the Registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods as such Registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the Registrants have submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrants were required to submit and post such files). Yes No

Indicate by check mark whether the Registrant, Select Medical Holdings Corporation, is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

Emerging Growth Company

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the Registrant, Select Medical Corporation, is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging Growth Company

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the Registrants are shell companies (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of October 31, 2017, Select Medical Holdings Corporation had outstanding 133,824,559 shares of common stock.

This Form 10-Q is a combined quarterly report being filed separately by two Registrants: Select Medical Holdings Corporation and Select Medical Corporation. Unless the context indicates otherwise, any reference in this report to “Holdings” refers to Select Medical Holdings Corporation and any reference to “Select” refers to Select Medical Corporation, the wholly owned operating subsidiary of Holdings, and any of Select’s subsidiaries. Any reference to “Concentra” refers to Concentra Inc., the indirect operating subsidiary of Concentra Group Holdings, LLC (“Concentra Group Holdings”), and its subsidiaries. References to the “Company,” “we,” “us,” and “our” refer collectively to Holdings, Select, and Concentra Group Holdings and its subsidiaries.

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PART I FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Condensed Consolidated Balance Sheets

(unaudited)

(in thousands, except share and per share amounts)

	Select Medical Holdings Corporation		Select Medical Corporation	
	December 31, 2016	September 30, 2017	December 31, 2016	September 30, 2017
ASSETS				
Current Assets:				
Cash and cash equivalents	\$ 99,029	\$ 107,300	\$ 99,029	\$ 107,300
Accounts receivable, net of allowance for doubtful accounts of \$63,787 and \$70,574 at 2016 and 2017, respectively	573,752	716,426	573,752	716,426
Prepaid income taxes	12,423	-	12,423	-
Other current assets	77,699	80,324	77,699	80,324
Total Current Assets	762,903	904,050	762,903	904,050
Property and equipment, net	892,217	946,063	892,217	946,063
Goodwill	2,751,000	2,767,896	2,751,000	2,767,896
Identifiable intangible assets, net	340,562	331,036	340,562	331,036
Other assets	173,944	174,762	173,944	174,762
Total Assets	\$ 4,920,626	\$ 5,123,807	\$ 4,920,626	\$ 5,123,807
LIABILITIES AND EQUITY				
Current Liabilities:				
Overdrafts	\$ 39,362	\$ 18,923	\$ 39,362	\$ 18,923
Current portion of long-term debt and notes payable	13,656	37,560	13,656	37,560
Accounts payable	126,558	133,321	126,558	133,321
Accrued payroll	146,397	139,402	146,397	139,402
Accrued vacation	83,261	89,171	83,261	89,171
Accrued interest	22,325	30,998	22,325	30,998
Accrued other	140,076	143,443	140,076	143,443
Income taxes payable	-	6,718	-	6,718
Total Current Liabilities	571,635	599,536	571,635	599,536
Long-term debt, net of current portion	2,685,333	2,752,742	2,685,333	2,752,742
Non-current deferred tax liability	199,078	191,441	199,078	191,441
Other non-current liabilities	136,520	138,118	136,520	138,118
Total Liabilities	3,592,566	3,681,837	3,592,566	3,681,837
Commitments and contingencies (Note 8)				
Redeemable non-controlling interests	422,159	621,515	422,159	621,515
Stockholders' Equity:				
Common stock of Holdings, \$0.001 par value, 700,000,000 shares authorized, 132,596,758 and 133,884,963 shares issued and outstanding at 2016 and 2017, respectively	132	133	-	-
Common stock of Select, \$0.01 par value, 100 shares issued and outstanding	-	-	0	0
Capital in excess of par	443,908	459,004	925,111	942,142
Retained earnings (accumulated deficit)	371,685	262,505	(109,386)	(220,500)
Total Select Medical Holdings Corporation and Select Medical Corporation Stockholders' Equity	815,725	721,642	815,725	721,642
Non-controlling interests	90,176	98,813	90,176	98,813
Total Equity	905,901	820,455	905,901	820,455
Total Liabilities and Equity	\$ 4,920,626	\$ 5,123,807	\$ 4,920,626	\$ 5,123,807

The accompanying notes are an integral part of these condensed consolidated financial statements.

Condensed Consolidated Statements of Operations
 (unaudited)
 (in thousands, except per share amounts)

	Select Medical Holdings Corporation		Select Medical Corporation	
	For the Three Months Ended September 30,		For the Three Months Ended September 30,	
	2016	2017	2016	2017
Net operating revenues	\$ 1,053,795	\$ 1,097,166	\$ 1,053,795	\$ 1,097,166
Costs and expenses:				
Cost of services	915,703	938,910	915,703	938,910
General and administrative	27,088	27,065	27,088	27,065
Bad debt expense	17,677	20,321	17,677	20,321
Depreciation and amortization	37,165	38,772	37,165	38,772
Total costs and expenses	<u>997,633</u>	<u>1,025,068</u>	<u>997,633</u>	<u>1,025,068</u>
Income from operations	56,162	72,098	56,162	72,098
Other income and expense:				
Loss on early retirement of debt	(10,853)	-	(10,853)	-
Equity in earnings of unconsolidated subsidiaries	5,268	4,431	5,268	4,431
Non-operating loss	(1,028)	-	(1,028)	-
Interest expense	<u>(44,482)</u>	<u>(37,688)</u>	<u>(44,482)</u>	<u>(37,688)</u>
Income before income taxes	5,067	38,841	5,067	38,841
Income tax expense	<u>1,075</u>	<u>14,017</u>	<u>1,075</u>	<u>14,017</u>
Net income	<u>3,992</u>	<u>24,824</u>	<u>3,992</u>	<u>24,824</u>
Less: Net income (loss) attributable to non-controlling interests	<u>(2,479)</u>	<u>6,362</u>	<u>(2,479)</u>	<u>6,362</u>
Net income attributable to Select Medical Holdings Corporation and Select Medical Corporation	<u>\$ 6,471</u>	<u>\$ 18,462</u>	<u>\$ 6,471</u>	<u>\$ 18,462</u>
Income per common share:				
Basic	\$ 0.05	\$ 0.14		
Diluted	\$ 0.05	\$ 0.14		
Weighted average shares outstanding:				
Basic	127,848	129,142		
Diluted	127,989	129,322		

The accompanying notes are an integral part of these condensed consolidated financial statements.

Condensed Consolidated Statements of Operations
 (unaudited)
 (in thousands, except per share amounts)

	Select Medical Holdings Corporation		Select Medical Corporation	
	For the Nine Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2017	2016	2017
Net operating revenues	\$ 3,239,756	\$ 3,329,202	\$ 3,239,756	\$ 3,329,202
Costs and expenses:				
Cost of services	2,754,950	2,787,497	2,754,950	2,787,497
General and administrative	81,226	83,415	81,226	83,415
Bad debt expense	51,591	59,120	51,591	59,120
Depreciation and amortization	107,887	119,644	107,887	119,644
Total costs and expenses	<u>2,995,654</u>	<u>3,049,676</u>	<u>2,995,654</u>	<u>3,049,676</u>
Income from operations	244,102	279,526	244,102	279,526
Other income and expense:				
Loss on early retirement of debt	(11,626)	(19,719)	(11,626)	(19,719)
Equity in earnings of unconsolidated subsidiaries	14,466	15,618	14,466	15,618
Non-operating gain (loss)	37,094	(49)	37,094	(49)
Interest expense	<u>(127,662)</u>	<u>(116,196)</u>	<u>(127,662)</u>	<u>(116,196)</u>
Income before income taxes	156,374	159,180	156,374	159,180
Income tax expense	51,585	59,593	51,585	59,593
Net income	<u>104,789</u>	<u>99,587</u>	<u>104,789</u>	<u>99,587</u>
Less: Net income attributable to non-controlling interests	<u>9,550</u>	<u>23,200</u>	<u>9,550</u>	<u>23,200</u>
Net income attributable to Select Medical Holdings Corporation and Select Medical Corporation	<u>\$ 95,239</u>	<u>\$ 76,387</u>	<u>\$ 95,239</u>	<u>\$ 76,387</u>
Income per common share:				
Basic	\$ 0.72	\$ 0.57	\$ 0.57	\$ 0.57
Diluted	\$ 0.72	\$ 0.57	\$ 0.57	\$ 0.57
Weighted average shares outstanding:				
Basic	127,659	128,745	127,804	128,916
Diluted				

The accompanying notes are an integral part of these condensed consolidated financial statements.

Condensed Consolidated Statements of Changes in Equity and Income
 (unaudited)
 (in thousands)

	Select Medical Holdings Corporation Stockholders							
	Redeemable Non-controlling interests	Common Stock Issued	Common Stock Par Value	Capital in Excess of Par	Retained Earnings	Total Stockholders' Equity	Non-controlling Interests	Total Equity
Balance at December 31, 2016	\$ 422,159	132,597	\$ 132	\$ 443,908	\$ 371,685	\$ 815,725	\$ 90,176	\$ 905,901
Net income attributable to Select Medical Holdings Corporation					76,387	76,387		76,387
Net income attributable to non-controlling interests	18,519					-	4,681	4,681
Issuance and vesting of restricted stock		1,323	1	13,445		13,446		13,446
Repurchase of common shares		(220)	0	(1,934)	(1,669)	(3,603)		(3,603)
Exercise of stock options		185	0	1,634		1,634		1,634
Issuance of non-controlling interests				1,951		1,951	8,944	10,895
Purchase of non-controlling interests	(127)				7	7		7
Distributions to non-controlling interests	(4,003)					-	(5,153)	(5,153)
Redemption adjustment on non-controlling interests	184,294				(184,294)	(184,294)		(184,294)
Other	673				389	389	165	554
Balance at September 30, 2017	\$ 621,515	133,885	\$ 133	\$ 459,004	\$ 262,505	\$ 721,642	\$ 98,813	\$ 820,455

	Select Medical Corporation Stockholders							
	Redeemable Non-controlling interests	Common Stock Issued	Common Stock Par Value	Capital in Excess of Par	Retained Earnings	Total Stockholders' Equity	Non-controlling Interests	Total Equity
Balance at December 31, 2016	\$ 422,159	0	\$ 0	\$ 925,111	\$ (109,386)	\$ 815,725	\$ 90,176	\$ 905,901
Net income attributable to Select Medical Corporation					76,387	76,387		76,387
Net income attributable to non-controlling interests	18,519				-	4,681	4,681	4,681
Additional investment by Holdings				1,634		1,634		1,634
Dividends declared and paid to Holdings					(3,603)	(3,603)		(3,603)
Contribution related to restricted stock awards and stock option issuances by Holdings				13,446		13,446		13,446
Issuance of non-controlling interests				1,951		1,951	8,944	10,895
Purchase of non-controlling interests	(127)				7	7		7
Distributions to non-controlling interests	(4,003)					-	(5,153)	(5,153)
Redemption adjustment on non-controlling interests	184,294				(184,294)	(184,294)		(184,294)
Other	673				389	389	165	554
Balance at September 30, 2017	\$ 621,515	0	\$ 0	\$ 942,142	\$ (220,500)	\$ 721,642	\$ 98,813	\$ 820,455

The accompanying notes are an integral part of these condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows
 (unaudited)
 (in thousands)

	Select Medical Holdings Corporation		Select Medical Corporation	
	For the Nine Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2017	2016	2017
Operating activities				
Net income	\$ 104,789	\$ 99,587	\$ 104,789	\$ 99,587
Adjustments to reconcile net income to net cash provided by operating activities:				
Distributions from unconsolidated subsidiaries	16,145	14,542	16,145	14,542
Depreciation and amortization	107,887	119,644	107,887	119,644
Provision for bad debts	51,591	59,120	51,591	59,120
Equity in earnings of unconsolidated subsidiaries	(14,466)	(15,618)	(14,466)	(15,618)
Loss on extinguishment of debt	11,626	6,527	11,626	6,527
Gain on sale or disposal of assets and businesses	(41,910)	(9,499)	(41,910)	(9,499)
Gain on sale of equity investment	(241)	-	(241)	-
Impairment of equity investment	5,339	-	5,339	-
Stock compensation expense	12,924	14,227	12,924	14,227
Amortization of debt discount, premium and issuance costs	11,845	8,546	11,845	8,546
Deferred income taxes	(13,088)	(6,126)	(13,088)	(6,126)
Changes in operating assets and liabilities, net of effects of business combinations:				
Accounts receivable	(40,776)	(201,514)	(40,776)	(201,514)
Other current assets	12,094	(2,677)	12,094	(2,677)
Other assets	5,146	1,407	5,146	1,407
Accounts payable	(17,752)	3,913	(17,752)	3,913
Accrued expenses	52,996	18,752	52,996	18,752
Due to third party payors	11,065	-	11,065	-
Income taxes	5,547	19,141	5,547	19,141
Net cash provided by operating activities	<u>280,761</u>	<u>129,972</u>	<u>280,761</u>	<u>129,972</u>
Investing activities				
Business combinations, net of cash acquired	(414,231)	(19,371)	(414,231)	(19,371)
Purchases of property and equipment	(118,260)	(173,800)	(118,260)	(173,800)
Investment in businesses	(3,140)	(11,374)	(3,140)	(11,374)
Proceeds from sale of assets, businesses, and equity investment	72,629	34,555	72,629	34,555
Net cash used in investing activities	<u>(463,002)</u>	<u>(169,990)</u>	<u>(463,002)</u>	<u>(169,990)</u>
Financing activities				
Borrowings on revolving facilities	420,000	805,000	420,000	805,000
Payments on revolving facilities	(545,000)	(705,000)	(545,000)	(705,000)
Proceeds from term loans	795,344	1,139,487	795,344	1,139,487
Payments on term loans	(434,842)	(1,176,567)	(434,842)	(1,176,567)
Revolving facility debt issuance costs	-	(4,392)	-	(4,392)
Borrowings of other debt	23,801	27,571	23,801	27,571
Principal payments on other debt	(15,477)	(15,112)	(15,477)	(15,112)
Repurchase of common stock	(1,939)	(3,603)	-	-
Dividends paid to Holdings	-	-	(1,939)	(3,603)
Proceeds from exercise of stock options	1,488	1,634	-	-
Equity investment by Holdings	-	-	1,488	1,634
Rewpayments of overdrafts	(8,464)	(20,439)	(8,464)	(20,439)
Proceeds from issuance of non-controlling interests	11,846	8,986	11,846	8,986
Purchase of non-controlling interests	(1,530)	(120)	(1,530)	(120)
Distributions to non-controlling interests	(9,198)	(9,156)	(9,198)	(9,156)
Net cash provided by financing activities	<u>236,029</u>	<u>48,289</u>	<u>236,029</u>	<u>48,289</u>
Net increase in cash and cash equivalents	53,788	8,271	53,788	8,271
Cash and cash equivalents at beginning of period	14,435	99,029	14,435	99,029
Cash and cash equivalents at end of period	<u>\$ 68,223</u>	<u>\$ 107,300</u>	<u>\$ 68,223</u>	<u>\$ 107,300</u>
Supplemental Information				
Cash paid for interest	\$ 92,928	\$ 101,341	\$ 92,928	\$ 101,341
Cash paid for taxes	\$ 59,937	\$ 46,553	\$ 59,937	\$ 46,553

The accompanying notes are an integral part of these condensed consolidated financial statements.

SELECT MEDICAL HOLDINGS CORPORATION AND SELECT MEDICAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

The unaudited condensed consolidated financial statements of Select Medical Holdings Corporation (“Holdings”) include the accounts of its wholly owned subsidiary, Select Medical Corporation (“Select”). Holdings conducts substantially all of its business through Select and its subsidiaries. Holdings and Select and its subsidiaries are collectively referred to as the “Company.” The unaudited condensed consolidated financial statements of the Company as of September 30, 2017, and for the three and nine month periods ended September 30, 2016 and 2017, have been prepared pursuant to the rules and regulations of the Securities Exchange Commission (the “SEC”) for interim reporting and accounting principles generally accepted in the United States of America (“GAAP”). Accordingly, certain information and disclosures required by GAAP, which are normally included in the notes to consolidated financial statements, have been condensed or omitted pursuant to those rules and regulations, although the Company believes the disclosure is adequate to make the information presented not misleading. In the opinion of management, such information contains all adjustments, which are normal and recurring in nature, necessary for a fair statement of the financial position, results of operations and cash flow for such periods. All significant intercompany transactions and balances have been eliminated.

The results of operations for the three and nine months ended September 30, 2017 are not necessarily indicative of the results to be expected for the full fiscal year ending December 31, 2017. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2016 contained in the Company’s Annual Report on Form 10-K filed with the SEC on February 23, 2017.

2. Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosure of contingencies, at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2017-01, *Business Combinations (Topic 805), Clarifying the Definition of a Business*, which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. ASU 2017-01 states that if substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the transaction should be accounted for as an asset acquisition. In addition, the ASU clarifies the requirements for a set of activities to be considered a business and narrows the definition of an output. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill and consolidation. ASU 2017-01 will be applied prospectively and is effective for annual periods beginning after December 15, 2017. Early adoption is permitted.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740), Intra-Entity Transfers of Assets Other Than Inventory*. Current GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. The ASU requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The standard will be effective for fiscal years beginning after December 15, 2017. The Company plans to adopt the guidance effective January 1, 2018. Adoption of the guidance will be applied on a modified retrospective approach through a cumulative effect adjustment to retained earnings as of the effective date. The Company is currently evaluating the standard to determine the impact it will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU includes a lessee accounting model that recognizes two types of leases; finance and operating. This ASU requires that a lessee recognize on the balance sheet assets and liabilities for all leases with lease terms of more than twelve months. Lessees will need to recognize almost all leases on the balance sheet as a right-of-use asset and a lease liability. For income statement purposes, the FASB retained the dual model, requiring leases to be classified as either operating or finance. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or operating lease. For short-term leases of twelve months or less, lessees are permitted to make an accounting election by class of underlying asset not to recognize right-of-use assets or lease liabilities. If the alternative is elected, lease expense would be recognized generally on the straight-line basis over the respective lease term.

The amendments in ASU 2016-02 will take effect for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted as of the beginning of an interim or annual reporting period. A modified retrospective approach is required for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements.

Upon adoption, the Company will recognize significant assets and liabilities on the consolidated balance sheets as a result of the operating lease obligations of the Company. Operating lease expense will still be recognized as rent expense on a straight-line basis over the respective lease terms in the consolidated statements of operations.

The Company will implement the new standard beginning January 1, 2019. The Company's implementation efforts are focused on designing accounting processes, disclosure processes, and internal controls in order to account for its leases under the new standard.

In May 2014, March 2016, April 2016, and December 2016, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, ASU 2016-08, *Revenue from Contracts with Customers, Principal versus Agent Considerations*, ASU 2016-10, *Revenue from Contracts with Customers, Identifying Performance Obligations and Licensing*, ASU 2016-12, *Revenue from Contracts with Customers, Narrow Scope Improvements and Practical Expedients*, and ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customer* (collectively "the standards"), respectively, which supersede most of the current revenue recognition requirements. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. New disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers are also required. The standards require the selection of a retrospective or cumulative effect transition method.

The Company will implement the new standard beginning January 1, 2018 using the retrospective transition method. Adoption of the new standard will result in material changes to the presentation of net operating revenues and bad debt expense in the consolidated statements of operations, but the presentation of the amount of income from operations and net income is not expected to materially change upon adoption of the new standards. The principal change is how the new standard requires healthcare providers to estimate the amount of variable consideration to be included in the transaction price up to an amount which is probable that a significant reversal will not occur. The most common form of variable consideration the Company experiences are amounts for services provided that are ultimately not realizable from a customer. Under the current standards, the Company's estimate for unrealizable amounts was recorded to bad debt expense. Under the new standards, the Company's estimate for unrealizable amounts will be recognized as a constraint to revenue and will be reflected as an allowance. Substantially all of the bad debt expense as of September 30, 2016 and September 30, 2017 will be reclassified as an allowance when the Company retrospectively applies the guidance in the standards on January 1, 2018.

The Company's remaining implementation efforts are focused principally on refining the accounting processes, disclosure processes, and internal controls.

Recently Adopted Accounting Pronouncements

In November 2015, the FASB issued ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*, which changed the presentation of deferred income taxes. The standard changed the presentation of deferred income taxes through the requirement that all deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The Company adopted the standard on January 1, 2017. The consolidated balance sheet at December 31, 2016 has been retrospectively adjusted. Adoption of the new standard impacted the Company's previously reported results as follows:

	December 31, 2016	
	As Reported	As Adjusted
	(in thousands)	
Current deferred tax asset	\$ 45,165	\$ —
Total current assets	808,068	762,903
Other assets	152,548	173,944
Total assets	4,944,395	4,920,626
Non-current deferred tax liability	222,847	199,078
Total liabilities	3,616,335	3,592,566
Total liabilities and equity	4,944,395	4,920,626

Reclassifications

Certain reclassifications have been made to prior year amounts in order to conform to current year presentation. As discussed above, the condensed consolidated balance sheet at December 31, 2016 has been changed in order to conform to the current year balance sheet presentation for the adoption of ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*.

3. Acquisitions

Physiotherapy Acquisition

On March 4, 2016, Select acquired 100% of the issued and outstanding equity securities of Physiotherapy Associates Holdings, Inc. ("Physiotherapy") for \$406.3 million, net of \$12.3 million of cash acquired.

For the Physiotherapy acquisition, the Company allocated the purchase price to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair value in accordance with the provisions of Accounting Standards Codification ("ASC") 805, *Business Combinations*. During the quarter ended March 31, 2017, the Company finalized the purchase price allocation.

The following table reconciles the allocation of the consideration given for identifiable net assets and goodwill acquired to the net cash paid for the acquired business (in thousands):

Cash and cash equivalents	\$ 12,340
Identifiable tangible assets, excluding cash and cash equivalents	87,832
Identifiable intangible assets	32,484
Goodwill	343,187
Total assets	475,843
Total liabilities	54,685
Acquired non-controlling interests	2,514
Net assets acquired	418,644
Less: Cash and cash equivalents acquired	(12,340)
Net cash paid	<u><u>\$ 406,304</u></u>

Goodwill of \$343.2 million has been recognized in the business combination, representing the excess of the consideration given over the fair value of identifiable net assets acquired. The value of goodwill is derived from Physiotherapy's future earnings potential and its assembled workforce. Goodwill has been assigned to the outpatient rehabilitation reporting unit and is not deductible for tax purposes. However, prior to its acquisition by the Company, Physiotherapy completed certain acquisitions that resulted in tax deductible goodwill with an estimated value of \$8.8 million, which the Company will deduct through 2030.

Due to the integration of Physiotherapy into our outpatient rehabilitation operations, it is not practicable to separately identify net revenue and earnings of Physiotherapy on a stand-alone basis.

The following pro forma unaudited results of operations have been prepared assuming the acquisition of Physiotherapy occurred on January 1, 2015. These results are not necessarily indicative of results of future operations nor of the results that would have actually occurred had the acquisition been consummated on the aforementioned date. The Company's results of operations for the three months ended September 30, 2016 and for the three and nine months ended September 30, 2017 include Physiotherapy for the entire period. There were no pro forma adjustments during these periods; therefore, no pro forma information is presented.

	Nine Months Ended September 30, 2016 <hr/>
	(in thousands, except per share amounts)
Net revenue	\$ 3,293,286
Net income attributable to Holdings	93,418
Income per common share:	
Basic	\$ 0.71
Diluted	\$ 0.71

The net income tax impact was calculated at a statutory rate, as if Physiotherapy had been a subsidiary of the Company as of January 1, 2015. Pro forma results for the nine months ended September 30, 2016 were adjusted to exclude approximately \$3.2 million of Physiotherapy acquisition costs.

Other Acquisitions

The Company completed acquisitions within our specialty hospitals, outpatient rehabilitation, and Concentra segments during the nine months ended September 30, 2017. The Company provided total consideration of \$21.7 million, consisting principally of \$19.4 million of cash and the issuance of non-controlling interests. The assets received in these acquisitions consisted principally of accounts receivable, property and equipment, identifiable intangible assets, and goodwill, of which \$0.8 million, \$1.8 million, and \$14.5 million of goodwill was recognized in our specialty hospitals, outpatient rehabilitation, and Concentra reporting units, respectively.

4. Intangible Assets and Liabilities

Goodwill

The following table shows changes in the carrying amounts of goodwill by reporting unit for the nine months ended September 30, 2017:

	Specialty Hospitals	Outpatient Rehabilitation	Concentra	Total
Balance as of December 31, 2016	\$ 1,447,406	\$ 643,557	\$ 660,037	\$ 2,751,000
Acquired	797	1,768	14,505	17,070
Measurement period adjustment	(342)	168	—	(174)
Balance as of September 30, 2017	<u>\$ 1,447,861</u>	<u>\$ 645,493</u>	<u>\$ 674,542</u>	<u>\$ 2,767,896</u>

See Note 3 for details of the goodwill acquired during the period.

Identifiable Intangible Assets and Liabilities

The following table provides the gross carrying amounts, accumulated amortization, and net carrying amounts for the Company's identifiable intangible assets and liabilities:

	December 31, 2016			September 30, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
(in thousands)						
Indefinite-lived assets:						
Trademarks	\$ 166,698	\$ —	\$ 166,698	\$ 166,698	\$ —	\$ 166,698
Certificates of need	17,026	—	17,026	19,166	—	19,166
Accreditations	2,235	—	2,235	1,965	—	1,965
Finite-lived assets:						
Customer relationships	142,198	(23,185)	119,013	143,953	(34,482)	109,471
Favorable leasehold interests	13,089	(2,317)	10,772	13,295	(3,745)	9,550
Non-compete agreements	26,655	(1,837)	24,818	27,555	(3,369)	24,186
Total identifiable intangible assets	<u>\$ 367,901</u>	<u>\$ (27,339)</u>	<u>\$ 340,562</u>	<u>\$ 372,632</u>	<u>\$ (41,596)</u>	<u>\$ 331,036</u>
Finite-lived liabilities:						
Unfavorable leasehold interests	\$ 5,139	\$ (1,410)	\$ 3,729	\$ 5,343	\$ (2,529)	\$ 2,814

The Company's customer relationships and non-compete agreements amortize over their estimated useful lives. Amortization expense was \$4.1 million and \$4.4 million for the three months ended September 30, 2016 and 2017, respectively. Amortization expense was \$12.2 million and \$13.1 million for the nine months ended September 30, 2016 and 2017, respectively.

The Company's favorable and unfavorable leasehold interests are amortized to rent expense over the remaining term of their respective leases to reflect a market rent per period based upon the market conditions present at the acquisition date. The Company's unfavorable leasehold interests are not separately presented on the condensed consolidated balance sheets but are included as a component of accrued other and other non-current liabilities.

The Company's accreditations and trademarks have renewal terms and the costs to renew these intangible assets are expensed as incurred. At September 30, 2017, the accreditations and trademarks have a weighted average time until next renewal of 1.5 years and 2.1 years, respectively.

5. Long-Term Debt and Notes Payable

For purposes of this indebtedness footnote, references to Select exclude Concentra because the Concentra credit facilities are non-recourse to Holdings and Select.

The Company's long-term debt and notes payable as of September 30, 2017 are as follows (in thousands):

	Principal Outstanding	Unamortized Premium (Discount)	Unamortized Issuance Costs	Carrying Value	Fair Value
<i>Select:</i>					
6.375% senior notes	\$ 710,000	\$ 835	\$ (7,032)	\$ 703,803	\$ 731,300
Credit facilities:					
Revolving facility	320,000	—	—	320,000	294,400
Term loan	1,144,250	(12,962)	(13,019)	1,118,269	1,158,553
Other	35,184	—	—	35,184	35,184
Total Select debt	2,209,434	(12,127)	(20,051)	2,177,256	2,219,437
<i>Concentra:</i>					
Credit facilities:					
Term loan	619,175	(2,385)	(11,268)	605,522	620,917
Other	7,524	—	—	7,524	7,524
Total Concentra debt	626,699	(2,385)	(11,268)	613,046	628,441
Total debt	<u>\$ 2,836,133</u>	<u>\$ (14,512)</u>	<u>\$ (31,319)</u>	<u>\$ 2,790,302</u>	<u>\$ 2,847,878</u>

Principal maturities of the Company's long-term debt and notes payable are approximately as follows (in thousands):

	2017	2018	2019	2020	2021	Thereafter	Total
<i>Select:</i>							
6.375% senior notes	\$ —	\$ —	\$ —	\$ —	\$ 710,000	\$ —	\$ 710,000
Credit facilities:							
Revolving facility	—	—	—	—	—	320,000	320,000
Term loan	2,875	11,500	11,500	11,500	11,500	1,095,375	1,144,250
Other	17,828	5,437	11,827	68	14	10	35,184
Total Select debt	20,703	16,937	23,327	11,568	721,514	1,415,385	2,209,434
<i>Concentra:</i>							
Credit facilities:							
Term loan	—	—	—	3,016	6,520	609,639	619,175
Other	657	2,843	144	161	160	3,559	7,524
Total Concentra debt	657	2,843	144	3,177	6,680	613,198	626,699
Total debt	<u>\$ 21,360</u>	<u>\$ 19,780</u>	<u>\$ 23,471</u>	<u>\$ 14,745</u>	<u>\$ 728,194</u>	<u>\$ 2,028,583</u>	<u>\$ 2,836,133</u>

The Company's long-term debt and notes payable as of December 31, 2016 are as follows (in thousands):

	Principal Outstanding	Unamortized Premium (Discount)	Unamortized Issuance Costs	Carrying Value	Fair Value
<i>Select:</i>					
6.375% senior notes	\$ 710,000	\$ 1,006	\$ (8,461)	\$ 702,545	\$ 710,000
Credit facilities:					
Revolving facility	220,000	—	—	220,000	204,600
Term loans	1,147,751	(11,967)	(13,581)	1,122,203	1,165,860
Other	22,688	—	—	22,688	22,688
Total Select debt	2,100,439	(10,961)	(22,042)	2,067,436	2,103,148
<i>Concentra:</i>					
Credit facilities:					
Term loan	642,239	(2,773)	(13,091)	626,375	644,648
Other	5,178	—	—	5,178	5,178
Total Concentra debt	647,417	(2,773)	(13,091)	631,553	649,826
Total debt	\$ 2,747,856	\$ (13,734)	\$ (35,133)	\$ 2,698,989	\$ 2,752,974

Select Credit Facilities

On March 6, 2017, Select entered into a new senior secured credit agreement (the "Select credit agreement") that provides for \$1.6 billion in senior secured credit facilities comprising a \$1.15 billion, seven-year term loan (the "Select term loan") and a \$450.0 million, five-year revolving credit facility (the "Select revolving facility" and together with the Select term loan, the "Select credit facilities"), including a \$75.0 million sublimit for the issuance of standby letters of credit.

Select used borrowings under the Select credit facilities to: (i) repay in full the series E tranche B term loans due June 1, 2018, the series F tranche B term loans due March 31, 2021, and the revolving facility maturing March 1, 2018 under its then existing credit facilities; and (ii) pay fees and expenses in connection with the refinancing, which resulted in \$6.5 million of debt extinguishment losses and \$13.2 million of debt modification losses during the first quarter of 2017.

Borrowings under the Select credit facilities bear interest at a rate equal to: (i) in the case of the Select term loan, Adjusted LIBO (as defined in the Select credit agreement) plus 3.50% (subject to an Adjusted LIBO floor of 1.00%), or Alternate Base Rate (as defined in the Select credit agreement) plus 2.50% (subject to an Alternate Base Rate floor of 2.00%); and (ii) in the case of the Select revolving facility, Adjusted LIBO plus a percentage ranging from 3.00% to 3.25% or Alternate Base Rate plus a percentage ranging from 2.00% to 2.25%, in each case based on Select's leverage ratio.

The Select term loan amortizes in equal quarterly installments in amounts equal to 0.25% of the aggregate original principal amount of the Select term loan commencing on June 30, 2017. The balance of the Select term loan will be payable on March 8, 2024; however, if the Select 6.375% senior notes, which are due June 1, 2021, are outstanding on March 1, 2021, the maturity date for the Select term loan will become March 1, 2021. The Select revolving facility will be payable on March 8, 2022; however, if the Select 6.375% senior notes are outstanding on February 1, 2021, the maturity date for the Select revolving facility will become February 1, 2021.

Select will be required to prepay borrowings under the Select credit facilities with (i) 100% of the net cash proceeds received from non-ordinary course asset sales or other dispositions, or as a result of a casualty or condemnation, subject to reinvestment provisions and other customary carveouts and, to the extent required, the payment of certain indebtedness secured by liens having priority over the debt under the Select credit facilities or subject to a first lien intercreditor agreement, (ii) 100% of the net cash proceeds received from the issuance of debt obligations other than certain permitted debt obligations, and (iii) 50% of excess cash flow (as defined in the Select credit agreement) if Select's leverage ratio is greater than 4.50 to 1.00 and 25% of excess cash flow if Select's leverage ratio is less than or equal to 4.50 to 1.00 and greater than 4.00 to 1.00, in each case, reduced by the aggregate amount of term loans, revolving loans and certain other debt optionally prepaid during the applicable fiscal year. Select will not be required to prepay borrowings with excess cash flow if Select's leverage ratio is less than or equal to 4.00 to 1.00.

The Select revolving facility requires Select to maintain a leverage ratio (as defined in the Select credit agreement), which is tested quarterly, not to exceed 6.25 to 1.00. After March 31, 2019, the leverage ratio must not exceed 6.00 to 1.00. Failure to comply with this covenant would result in an event of default under the Select revolving facility and, absent a waiver or an amendment from the revolving lenders, preclude Select from making further borrowings under the Select revolving facility and permit the revolving lenders to accelerate all outstanding borrowings under the Select revolving facility. The termination of the Select revolving facility commitments and the acceleration of amounts outstanding thereunder would constitute an event of default with respect to the Select term loan. As of September 30, 2017, Select's leverage ratio was 5.82 to 1.00.

The Select credit facilities also contain a number of other affirmative and restrictive covenants, including limitations on mergers, consolidations and dissolutions; sales of assets; investments and acquisitions; indebtedness; liens; affiliate transactions; and dividends and restricted payments. The Select credit facilities contain events of default for non-payment of principal and interest when due (subject, as to interest, to a grace period), cross-default and cross-acceleration provisions and an event of default that would be triggered by a change of control.

Borrowings under the Select credit facilities are guaranteed by Holdings and substantially all of Select's current domestic subsidiaries and will be guaranteed by substantially all of Select's future domestic subsidiaries and secured by substantially all of Select's existing and future property and assets and by a pledge of Select's capital stock, the capital stock of Select's domestic subsidiaries and up to 65% of the capital stock of Select's foreign subsidiaries held directly by Select or a domestic subsidiary.

Excess Cash Flow Payment

On March 1, 2017, Concentra made a principal prepayment of \$23.1 million associated with the Concentra first lien term loans in accordance with the provision in the Concentra credit facilities that requires mandatory prepayments of term loans as a result of annual excess cash flow, as defined in the Concentra credit facilities.

Fair Value

The Company considers the inputs in the valuation process to be Level 2 in the fair value hierarchy for Select's 6.375% senior notes and for its credit facilities. Level 2 in the fair value hierarchy is defined as inputs that are observable for the asset or liability, either directly or indirectly, which includes quoted prices for identical assets or liabilities in markets that are not active.

The fair values of the Select credit facilities and the Concentra credit facilities were based on quoted market prices for this debt in the syndicated loan market. The fair value of Select's 6.375% senior notes was based on quoted market prices. The carrying amount of other debt, principally short-term notes payable, approximates fair value.

6. Segment Information

The Company's reportable segments consist of: specialty hospitals, outpatient rehabilitation, and Concentra. Other activities include the Company's corporate shared services and certain other non-consolidating joint ventures and minority investments in other healthcare related businesses. The Company evaluates performance of the segments based on Adjusted EBITDA. Adjusted EBITDA is defined as earnings excluding interest, income taxes, depreciation and amortization, gain (loss) on early retirement of debt, stock compensation expense, Physiotherapy acquisition costs, non-operating gain (loss), and equity in earnings (losses) of unconsolidated subsidiaries.

The following tables summarize selected financial data for the Company's reportable segments. The segment results of Holdings are identical to those of Select.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2017	2016	2017
	(in thousands)			
Net operating revenues:				
Specialty hospitals	\$ 544,491	\$ 585,288	\$ 1,729,261	\$ 1,785,035
Outpatient rehabilitation ⁽¹⁾	250,710	250,527	745,720	764,450
Concentra	258,507	261,295	764,252	779,030
Other	87	56	523	687
Total Company	\$ 1,053,795	\$ 1,097,166	\$ 3,239,756	\$ 3,329,202
Adjusted EBITDA:				
Specialty hospitals	\$ 48,264	\$ 69,454	\$ 217,759	\$ 256,291
Outpatient rehabilitation ⁽¹⁾	31,995	29,298	99,006	102,575
Concentra	40,888	40,003	118,080	125,656
Other	(23,070)	(22,928)	(66,696)	(71,125)
Total Company	\$ 98,077	\$ 115,827	\$ 368,149	\$ 413,397
Total assets:⁽²⁾				
Specialty hospitals	\$ 2,469,060	\$ 2,748,761	\$ 2,469,060	\$ 2,748,761
Outpatient rehabilitation	955,359	945,765	955,359	945,765
Concentra	1,318,866	1,332,012	1,318,866	1,332,012
Other	73,992	97,269	73,992	97,269
Total Company	\$ 4,817,277	\$ 5,123,807	\$ 4,817,277	\$ 5,123,807
Purchases of property and equipment, net:				
Specialty hospitals	\$ 24,378	\$ 37,376	\$ 79,366	\$ 106,424
Outpatient rehabilitation ⁽¹⁾	6,234	6,496	15,032	19,370
Concentra	2,720	5,369	10,647	21,656
Other	4,670	19,257	13,215	26,350
Total Company	\$ 38,002	\$ 68,498	\$ 118,260	\$ 173,800

A reconciliation of Adjusted EBITDA to income before income taxes is as follows:

	Three Months Ended September 30, 2016				
	Specialty Hospitals	Outpatient Rehabilitation ⁽¹⁾	Concentra		
			(in thousands)	Other	Total
Adjusted EBITDA	\$ 48,264	\$ 31,995	\$ 40,888	\$ (23,070)	
Depreciation and amortization	(14,317)	(6,159)	(15,278)	(1,411)	
Stock compensation expense	—	—	(193)	(4,557)	
Income (loss) from operations	\$ 33,947	\$ 25,836	\$ 25,417	\$ (29,038)	\$ 56,162
Loss on early retirement of debt					(10,853)
Equity in earnings of unconsolidated subsidiaries					5,268
Non-operating loss					(1,028)
Interest expense					(44,482)
Income before income taxes					\$ 5,067

Three Months Ended September 30, 2017

	Specialty Hospitals	Outpatient Rehabilitation	Concentra	Other	Total
			(in thousands)		
Adjusted EBITDA	\$ 69,454	\$ 29,298	\$ 40,003	\$ (22,928)	
Depreciation and amortization	(15,437)	(5,964)	(15,014)	(2,357)	
Stock compensation expense	—	—	(212)	(4,745)	
Income (loss) from operations	\$ 54,017	\$ 23,334	\$ 24,777	\$ (30,030)	\$ 72,098
Equity in earnings of unconsolidated subsidiaries					4,431
Interest expense					(37,688)
Income before income taxes					<u>\$ 38,841</u>

Nine Months Ended September 30, 2016

	Specialty Hospitals	Outpatient Rehabilitation⁽¹⁾	Concentra	Other	Total
			(in thousands)		
Adjusted EBITDA	\$ 217,759	\$ 99,006	\$ 118,080	\$ (66,696)	
Depreciation and amortization	(42,022)	(16,397)	(45,570)	(3,898)	
Stock compensation expense	—	—	(577)	(12,347)	
Physiotherapy acquisition costs	—	—	—	(3,236)	
Income (loss) from operations	\$ 175,737	\$ 82,609	\$ 71,933	\$ (86,177)	\$ 244,102
Loss on early retirement of debt					(11,626)
Equity in earnings of unconsolidated subsidiaries					14,466
Non-operating gain					37,094
Interest expense					(127,662)
Income before income taxes					<u>\$ 156,374</u>

Nine Months Ended September 30, 2017

	Specialty Hospitals	Outpatient Rehabilitation	Concentra	Other	Total
			(in thousands)		
Adjusted EBITDA	\$ 256,291	\$ 102,575	\$ 125,656	\$ (71,125)	
Depreciation and amortization	(49,391)	(18,182)	(46,566)	(5,505)	
Stock compensation expense	—	—	(782)	(13,445)	
Income (loss) from operations	\$ 206,900	\$ 84,393	\$ 78,308	\$ (90,075)	\$ 279,526
Loss on early retirement of debt					(19,719)
Equity in earnings of unconsolidated subsidiaries					15,618
Non-operating loss					(49)
Interest expense					(116,196)
Income before income taxes					<u>\$ 159,180</u>

- (1) The outpatient rehabilitation segment includes the operating results of the Company's contract therapy businesses through March 31, 2016 and Physiotherapy beginning March 4, 2016.
- (2) Reflects the retrospective adoption of ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*. Total assets as of September 30, 2016 were retrospectively conformed to reflect the adoption of the standard, resulting in a reduction to total assets of \$28.1 million.

7. Income per Common Share

Holdings applies the two-class method for calculating and presenting income per common share. The two-class method is an earnings allocation formula that determines earnings per share for each class of stock participation rights in undistributed earnings.

The following table sets forth the calculation of income per share in Holdings' condensed consolidated statements of operations and the differences between basic weighted average shares outstanding and diluted weighted average shares outstanding used to compute basic and diluted earnings per share, respectively.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2017	2016	2017
	(in thousands, except per share amounts)			
Numerator:				
Net income attributable to Select Medical Holdings Corporation	\$ 6,471	\$ 18,462	\$ 95,239	\$ 76,387
Less: Earnings allocated to unvested restricted stockholders	209	608	2,852	2,464
Net income available to common stockholders	<u>\$ 6,262</u>	<u>\$ 17,854</u>	<u>\$ 92,387</u>	<u>\$ 73,923</u>
Denominator:				
Weighted average shares—basic	127,848	129,142	127,659	128,745
Effect of dilutive securities:				
Stock options	141	180	145	171
Weighted average shares—diluted	<u>127,989</u>	<u>129,322</u>	<u>127,804</u>	<u>128,916</u>
Basic income per common share:	\$ 0.05	\$ 0.14	\$ 0.72	\$ 0.57
Diluted income per common share:	\$ 0.05	\$ 0.14	\$ 0.72	\$ 0.57

8. Commitments and Contingencies

Litigation

The Company is a party to various legal actions, proceedings, and claims (some of which are not insured), and regulatory and other governmental audits and investigations in the ordinary course of its business. The Company cannot predict the ultimate outcome of pending litigation, proceedings, and regulatory and other governmental audits and investigations. These matters could potentially subject the Company to sanctions, damages, recoupments, fines, and other penalties. The Department of Justice, Centers for Medicare & Medicaid Services ("CMS"), or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company's businesses in the future that may, either individually or in the aggregate, have a material adverse effect on the Company's business, financial position, results of operations, and liquidity.

To address claims arising out of the Company's operations, the Company maintains professional malpractice liability insurance and general liability insurance, subject to self-insured retention of \$2.0 million per medical incident for professional liability claims and \$2.0 million per occurrence for general liability claims. The Company also maintains umbrella liability insurance covering claims which, due to their nature or amount, are not covered by or not fully covered by the Company's other insurance policies. These insurance policies also do not generally cover punitive damages and are subject to various deductibles and policy limits. Significant legal actions, as well as the cost and possible lack of available insurance, could subject the Company to substantial uninsured liabilities. In the Company's opinion, the outcome of these actions, individually or in the aggregate, will not have a material adverse effect on its financial position, results of operations or cash flows.

Healthcare providers are subject to lawsuits under the qui tam provisions of the federal False Claims Act. Qui tam lawsuits typically remain under seal (hence, usually unknown to the defendant) for some time while the government decides whether or not to intervene on behalf of a private qui tam plaintiff (known as a relator) and take the lead in the litigation. These lawsuits can involve significant monetary damages and penalties and award bounties to private plaintiffs who successfully bring the suits. The Company is and has been a defendant in these cases in the past, and may be named as a defendant in similar cases from time to time in the future.

Evansville Litigation

On October 19, 2015, the plaintiff-relators filed a Second Amended Complaint in United States of America, ex rel. Tracy Conroy, Pamela Schenk and Lisa Wilson v. Select Medical Corporation, Select Specialty Hospital—Evansville, LLC (“SSH-Evansville”), Select Employment Services, Inc., and Dr. Richard Sloan. The case is a civil action filed in the United States District Court for the Southern District of Indiana by private plaintiff-relators on behalf of the United States under the federal False Claims Act. The plaintiff-relators are the former CEO and two former case managers at SSH-Evansville, and the defendants currently include the Company, SSH-Evansville, a subsidiary of the Company serving as common paymaster for its employees, and a physician who practices at SSH-Evansville. The plaintiff-relators allege that SSH-Evansville discharged patients too early or held patients too long, improperly discharged patients to and readmitted them from short stay hospitals, up-coded diagnoses at admission, and admitted patients for whom long-term acute care was not medically necessary. They also allege that the defendants engaged in retaliation in violation of federal and state law. The Second Amended Complaint replaced a prior complaint that was filed under seal on September 28, 2012 and served on the Company on February 15, 2013, after a federal magistrate judge unsealed it on January 8, 2013. All deadlines in the case had been stayed after the seal was lifted in order to allow the government time to complete its investigation and to decide whether or not to intervene. On June 19, 2015, the United States Department of Justice notified the District Court of its decision not to intervene in the case.

In December 2015, the defendants filed a Motion to Dismiss the Second Amended Complaint on multiple grounds, including that the action is disallowed by the False Claims Act’s public disclosure bar, which disqualifies qui tam actions that are based on fraud already publicly disclosed through enumerated sources, unless the relator is an original source, and that the plaintiff-relators did not plead their claims with sufficient particularity, as required by the Federal Rules of Civil Procedure.

Thereafter, the United States filed a notice asserting a veto of the defendants’ use of the public disclosure bar for claims arising from conduct from and after March 23, 2010, which was based on certain statutory changes to the public disclosure bar language included in the Affordable Care Act. On September 30, 2016, the District Court partially granted and partially denied the defendants’ Motion to Dismiss. It ruled that the plaintiff-relators alleged substantially the same conduct as had been publicly disclosed and that the plaintiff relators are not original sources, so that the public disclosure bar requires dismissal of all non-retaliation claims arising from conduct before March 23, 2010. The District Court also ruled that the statutory changes to the public disclosure bar gave the United States the power to veto its applicability to claims arising from conduct on and after March 23, 2010, and therefore did not dismiss those claims based on the public disclosure bar. However, the District Court ruled that the plaintiff-relators did not plead certain of their claims relating to interrupted stay manipulation and premature discharging of patients with the requisite particularity, and dismissed those claims. The District Court declined to dismiss the plaintiff relators’ claims arising from conduct from and after March 23, 2010 relating to delayed discharging of patients and up-coding and the plaintiff relators’ retaliation claims. The plaintiff-relators then proposed a case management plan seeking nationwide discovery involving all of the Company’s LTCHs for the period from March 23, 2010 through the present, which the defendants have opposed. The Company intends to vigorously defend this action, but at this time the Company is unable to predict the timing and outcome of this matter.

Knoxville Litigation

On July 13, 2015, the United States District Court for the Eastern District of Tennessee unsealed a qui tam Complaint in Armes v. Garman, et al, No. 3:14-cv-00172-TAV-CCS, which named as defendants Select, Select Specialty Hospital—Knoxville, Inc. (“SSH-Knoxville”), Select Specialty Hospital—North Knoxville, Inc. and ten current or former employees of these facilities. The Complaint was unsealed after the United States and the State of Tennessee notified the court on July 13, 2015 that each had decided not to intervene in the case. The Complaint is a civil action that was filed under seal on April 29, 2014 by a respiratory therapist formerly employed at SSH-Knoxville. The Complaint alleges violations of the federal False Claims Act and the Tennessee Medicaid False Claims Act based on extending patient stays to increase reimbursement and to increase average length of stay; artificially prolonging the lives of patients to increase Medicare reimbursements and decrease inspections; admitting patients who do not require medically necessary care; performing unnecessary procedures and services; and delaying performance of procedures to increase billing. The Complaint was served on some of the defendants during October 2015.

In November 2015, the defendants filed a Motion to Dismiss the Complaint on multiple grounds. The defendants first argued that False Claims Act's first-to-file bar required dismissal of plaintiff-relator's claims. Under the first-to-file bar, if a qui tam case is pending, no person may bring a related action based on the facts underlying the first action. The defendants asserted that the plaintiff-relator's claims were based on the same underlying facts as were asserted in the Evansville litigation, discussed above. The defendants also argued that the plaintiff-relator's claims must be dismissed under the public disclosure bar, and because the plaintiff-relator did not plead his claims with sufficient particularity.

In June 2016, the District Court granted the defendants' Motion to Dismiss and dismissed with prejudice the plaintiff-relator's lawsuit in its entirety. The District Court ruled that the first-to-file bar precludes all but one of the plaintiff-relator's claims, and that the remaining claim must also be dismissed because the plaintiff-relator failed to plead it with sufficient particularity. In July 2016, the plaintiff-relator filed a Notice of Appeal to the United States Court of Appeals for the Sixth Circuit. Then, on October 11, 2016, the plaintiff-relator filed a Motion to Remand the case to the District Court for further proceedings, arguing that the September 30, 2016 decision in the Evansville litigation, discussed above, undermines the basis for the District Court's dismissal. After the Court of Appeals denied the Motion to Remand, the plaintiff-relator then sought an indicative ruling from the District Court that it would vacate its prior dismissal ruling and allow plaintiff-relator to supplement his Complaint, which the defendants have opposed. The case has been fully briefed and argued in the Court of Appeals. The Company intends to vigorously defend this action, but at this time the Company is unable to predict the timing and outcome of this matter.

Wilmington Litigation

On January 19, 2017, the United States District Court for the District of Delaware unsealed a qui tam Complaint in United States of America and State of Delaware ex rel. Theresa Kelly v. Select Specialty Hospital—Wilmington, Inc. (“SSH-Wilmington”), Select Specialty Hospitals, Inc., Select Employment Services, Inc., Select Medical Corporation, and Crystal Cheek, No. 16-347-LPS. The Complaint was initially filed under seal on May 12, 2016 by a former chief nursing officer at SSH-Wilmington and was unsealed after the United States filed a Notice of Election to Decline Intervention on January 13, 2017. The corporate defendants were served on March 6, 2017. In the complaint, the plaintiff-relator alleges that the Select defendants and an individual defendant, who is a former health information manager at SSH-Wilmington, violated the False Claims Act and the Delaware False Claims and Reporting Act based on allegedly falsifying medical practitioner signatures on medical records and failing to properly examine the credentials of medical practitioners at SSH-Wilmington. In response to the Select defendants' motion to dismiss the Complaint, on May 17, 2017 the plaintiff-relator filed an Amended Complaint asserting the same causes of action. The Select defendants filed a Motion to Dismiss the Amended Complaint, which is now pending, based on numerous grounds, including that the Amended Complaint did not plead any alleged fraud with sufficient particularity, failed to plead that the alleged fraud was material to the government's payment decision, failed to plead sufficient facts to establish that the Select defendants knowingly submitted false claims or records, and failed to allege any reverse false claim.

On March 24, 2017, the plaintiff-relator initiated a second action by filing a Complaint in the Superior Court of the State of Delaware in Theresa Kelly v. Select Medical Corporation, Select Employment Services, Inc., and SSH-Wilmington, C.A. No. N17C-03-293 CLS. The Delaware Complaint alleges that the defendants retaliated against her in violation of the Delaware Whistleblowers' Protection Act for reporting the same alleged violations that are the subject of the federal Amended Complaint. The defendants filed a motion to dismiss, or alternatively to stay, the Delaware Complaint based on the pending federal Amended Complaint and the failure to allege facts to support a violation of the Delaware Whistleblowers' Protection Act. The motion is currently pending.

The Company intends to vigorously defend these actions, but at this time the Company is unable to predict the timing and outcome of this matter.

Contract Therapy Subpoena

On May 18, 2017, the Company received a subpoena from the U.S. Attorney's Office for the District of New Jersey seeking various documents principally relating to the Company's contract therapy division, which contracted to furnish rehabilitation therapy services to residents of skilled nursing facilities ("SNFs") and other providers. The Company operated its contract therapy division through a subsidiary until March 31, 2016, when the Company sold the stock of the subsidiary. The subpoena seeks documents that appear to be aimed at assessing whether therapy services were furnished and billed in compliance with Medicare SNF billing requirements, including whether therapy services were coded at inappropriate levels and whether excessive or unnecessary therapy was furnished to justify coding at higher paying levels. The Company does not know whether the subpoena has been issued in connection with a qui tam lawsuit or in connection with possible civil, criminal or administrative proceedings by the government. The Company is producing documents in response to the subpoena and intends to fully cooperate with this investigation. At this time, the Company is unable to predict the timing and outcome of this matter.

Northern District of Alabama Investigation

On October 30, 2017, the Company was contacted by the U.S. Attorney's Office for the Northern District of Alabama to request cooperation in connection with an investigation that may involve Medicare billing compliance at certain of the Company's Physiotherapy outpatient rehabilitation clinics. The Company intends to cooperate with this investigation. At this time, the Company is unable to predict the timing and outcome of this matter.

9. Subsequent Event

On October 23, 2017, Select announced that Concentra Group Holdings entered into an Equity Purchase and Contribution Agreement (the "Purchase Agreement") dated October 22, 2017 with Concentra, Concentra Group Holdings Parent, LLC ("Group Holdings Parent"), U.S. HealthWorks, Inc. ("U.S. HealthWorks"), and Dignity Health Holdings Company ("DHHC"). Pursuant to the terms of the Purchase Agreement, Concentra will acquire the issued and outstanding shares of stock of U.S. HealthWorks, an occupational medicine and urgent care service provider.

In connection with the closing of the transaction, it is expected that Concentra Group Holdings will redeem certain of its outstanding equity interests from existing minority equity holders and subsequently, Concentra Group Holdings and a wholly owned subsidiary of Group Holdings Parent will merge, with Concentra Group Holdings surviving the merger and becoming a wholly owned subsidiary of Group Holdings Parent. As a result of the merger, the equity interests of Concentra Group Holdings outstanding after the redemption described above will be exchanged for membership interests in Group Holdings Parent.

The transaction values U.S. HealthWorks at \$753.0 million, subject to certain customary adjustments for working capital, cash, debt, transaction expenses and other items in accordance with the terms of the Purchase Agreement. DHHC, a subsidiary of Dignity Health, will be issued a 20% equity interest in Group Holdings Parent, which is valued at \$238.0 million. The remainder of the purchase price will be paid in cash. Select will retain a majority voting interest in Group Holdings Parent following the closing of the transaction.

Concentra expects to finance the transaction and related expenses using a proposed \$555.0 million senior secured incremental term facility under its existing credit facility and a proposed \$240.0 million second lien term facility, for which JP Morgan Chase, N.A. has provided Concentra with a debt commitment letter.

The transaction, which is expected to close in the first quarter of 2018, is subject to a number of closing conditions, including clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

10. Condensed Consolidating Financial Information

Select's 6.375% senior notes are fully and unconditionally and jointly and severally guaranteed, except for customary limitations, on a senior basis by all of Select's wholly owned subsidiaries (the "Subsidiary Guarantors"). The Subsidiary Guarantors are defined as subsidiaries where Select, or a subsidiary of Select, holds all of the outstanding ownership interests. Certain of Select's subsidiaries did not guarantee the 6.375% senior notes (the "Non-Guarantor Subsidiaries" and Concentra Group Holdings and its subsidiaries, the "Non-Guarantor Concentra").

Select conducts a significant portion of its business through its subsidiaries. Presented below is condensed consolidating financial information for Select, the Subsidiary Guarantors, the Non-Guarantor Subsidiaries, and Non-Guarantor Concentra at December 31, 2016 and September 30, 2017 and for the three and nine months ended September 30, 2016 and 2017.

The equity method has been used by Select with respect to investments in subsidiaries. The equity method has been used by Subsidiary Guarantors with respect to investments in Non-Guarantor Subsidiaries. Separate financial statements for Subsidiary Guarantors are not presented.

Certain reclassifications have been made to prior reported amounts in order to conform to the current year guarantor structure.

Select Medical Corporation
Condensed Consolidating Balance Sheet
September 30, 2017
(unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Consolidating and Eliminating Adjustments	Consolidated Select Medical Corporation
	(in thousands)					
Assets						
Current Assets:						
Cash and cash equivalents	\$ 73	\$ 6,359	\$ 4,548	\$ 96,320	\$ -	\$ 107,300
Accounts receivable, net	-	468,370	120,463	127,593	-	716,426
Intercompany receivables	-	1,488,527	36,784	-	(1,525,311) (a)	-
Prepaid income taxes	2,882	-	-	-	(2,882) (f)	-
Other current assets	10,937	30,142	16,814	22,431	-	80,324
Total Current Assets	13,892	1,993,398	178,609	246,344	(1,528,193)	904,050
Property and equipment, net	50,736	646,672	75,315	173,340	-	946,063
Investment in affiliates	4,421,777	116,370	-	-	(4,538,147) (b) (c)	-
Goodwill	-	2,093,354	-	674,542	-	2,767,896
Identifiable intangible assets, net	-	104,570	4,824	221,642	-	331,036
Other assets	42,852	101,285	36,285	16,144	(21,804) (e)	174,762
Total Assets	\$ 4,529,257	\$ 5,055,649	\$ 295,033	\$ 1,332,012	\$ (6,088,144)	\$ 5,123,807
Liabilities and Equity						
Current Liabilities:						
Overdrafts	\$ 18,923	\$ -	\$ -	\$ -	\$ -	\$ 18,923
Current portion of long-term debt and notes payable	30,838	773	2,483	3,466	-	37,560
Accounts payable	13,066	82,662	24,196	13,397	-	133,321
Intercompany payables	1,488,527	36,784	-	-	(1,525,311) (a)	-
Accrued payroll	11,186	86,257	3,931	38,028	-	139,402
Accrued vacation	3,848	55,949	12,040	17,334	-	89,171
Accrued interest	28,763	7	-	2,228	-	30,998
Accrued other	40,075	59,088	12,183	32,097	-	143,443
Income taxes payable	-	-	-	9,600	(2,882) (f)	6,718
Total Current Liabilities	1,635,226	321,520	54,833	116,150	(1,528,193)	599,536
Long-term debt, net of current portion	2,133,355	243	9,564	609,580	-	2,752,742
Non-current deferred tax liability	-	131,902	767	80,576	(21,804) (e)	191,441
Other non-current liabilities	39,034	55,572	8,039	35,473	-	138,118
Total Liabilities	3,807,615	509,237	73,203	841,779	(1,549,997)	3,681,837
Redeemable non-controlling interests	-	-	-	14,641	606,874 (d)	621,515
Stockholder's Equity:						
Common stock	0	-	-	-	-	0
Capital in excess of par	942,142	-	-	-	-	942,142
Retained earnings (accumulated deficit)	(220,500)	1,328,453	(40,068)	34,338	(1,322,723) (c) (d)	(220,500)
Subsidiary investment	-	3,217,959	261,898	437,568	(3,917,425) (b) (d)	-
Total Select Medical Corporation Stockholder's Equity	721,642	4,546,412	221,830	471,906	(5,240,148)	721,642
Non-controlling interests	-	-	-	3,686	95,127 (d)	98,813
Total Equity	721,642	4,546,412	221,830	475,592	(5,145,021)	820,455
Total Liabilities and Equity	\$ 4,529,257	\$ 5,055,649	\$ 295,033	\$ 1,332,012	\$ (6,088,144)	\$ 5,123,807

- (a) Elimination of intercompany balances.
- (b) Elimination of investments in consolidated subsidiaries.
- (c) Elimination of investments in consolidated subsidiaries' earnings.
- (d) Reclassification of equity attributable to non-controlling interests.
- (e) Reclassification of non-current deferred tax asset to report net non-current deferred tax liability in consolidation.
- (f) Reclassification of prepaid income taxes to report net income taxes payable in consolidation.

Select Medical Corporation
Condensed Consolidating Statement of Operations
For the Three Months Ended September 30, 2017
(unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Consolidating and Eliminating Adjustments	Consolidated Select Medical Corporation
	(in thousands)					
Net operating revenues	\$ 56	\$ 661,676	\$ 174,139	\$ 261,295	\$ -	\$ 1,097,166
Costs and expenses:						
Cost of services	667	570,564	151,609	216,070	-	938,910
General and administrative	27,028	37	-	-	-	27,065
Bad debt expense	-	10,879	4,008	5,434	-	20,321
Depreciation and amortization	2,355	17,982	3,421	15,014	-	38,772
Total costs and expenses	30,050	599,462	159,038	236,518	-	1,025,068
Income (loss) from operations	(29,994)	62,214	15,101	24,777	-	72,098
Other income and expense:						
Intercompany interest and royalty fees	7,864	(4,194)	(3,670)	-	-	-
Intercompany management fees	51,241	(41,048)	(10,193)	-	-	-
Equity in earnings of unconsolidated subsidiaries	-	4,416	15	-	-	4,431
Interest income (expense)	(30,239)	270	(20)	(7,699)	-	(37,688)
Income (loss) before income taxes	(1,128)	21,658	1,233	17,078	-	38,841
Income tax expense (benefit)	(1,032)	8,377	330	6,342	-	14,017
Equity in earnings of consolidated subsidiaries	18,558	399	-	-	(18,957) (a)	-
Net income	18,462	13,680	903	10,736	(18,957)	24,824
Less: Net income attributable to non-controlling interests	-	-	383	5,979	-	6,362
Net income attributable to Select Medical Corporation	\$ 18,462	\$ 13,680	\$ 520	\$ 4,757	\$ (18,957)	\$ 18,462

(a) Elimination of equity in earnings of consolidated subsidiaries.

Select Medical Corporation
Condensed Consolidating Statement of Operations
For the Nine Months Ended September 30, 2017
(unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Consolidating and Eliminating Adjustments	Consolidated Select Medical Corporation
	(in thousands)					
Net operating revenues	\$ 687	\$ 2,038,955	\$ 510,530	\$ 779,030	\$ -	\$ 3,329,202
Costs and expenses:						
Cost of services	1,843	1,713,091	434,130	638,433	-	2,787,497
General and administrative	83,291	124	-	-	-	83,415
Bad debt expense	-	32,456	10,941	15,723	-	59,120
Depreciation and amortization	5,503	57,471	10,104	46,566	-	119,644
Total costs and expenses	90,637	1,803,142	455,175	700,722	-	3,049,676
Income (loss) from operations	(89,950)	235,813	55,355	78,308	-	279,526
Other income and expense:						
Intercompany interest and royalty fees	24,760	(13,586)	(11,174)	-	-	-
Intercompany management fees	176,443	(147,117)	(29,326)	-	-	-
Loss on early retirement of debt	(19,719)	-	-	-	-	(19,719)
Equity in earnings of unconsolidated subsidiaries	-	15,555	63	-	-	15,618
Non-operating loss	-	(49)	-	-	-	(49)
Interest income (expense)	(93,725)	269	(104)	(22,636)	-	(116,196)
Income (loss) before income taxes	(2,191)	90,885	14,814	55,672	-	159,180
Income tax expense (benefit)	(3,230)	41,620	943	20,260	-	59,593
Equity in earnings of consolidated subsidiaries	75,348	10,174	-	-	(85,522) (a)	-
Net income	76,387	59,439	13,871	35,412	(85,522)	99,587
Less: Net income attributable to non-controlling interests	-	-	3,627	19,573	-	23,200
Net income attributable to Select Medical Corporation	<u>\$ 76,387</u>	<u>\$ 59,439</u>	<u>\$ 10,244</u>	<u>\$ 15,839</u>	<u>\$ (85,522)</u>	<u>\$ 76,387</u>

(a) Elimination of equity in earnings of consolidated subsidiaries.

Select Medical Corporation
Condensed Consolidating Statement of Cash Flows
For the Nine Months Ended September 30, 2017
(b unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Consolidating and Eliminating Adjustments	Consolidated Select Medical Corporation
(in thousands)						
Operating activities						
Net income	\$ 76,387	\$ 59,439	\$ 13,871	\$ 35,412	\$ (85,522) (a)	\$ 99,587
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Distributions from unconsolidated subsidiaries	-	14,493	49	-	-	14,542
Depreciation and amortization	5,503	57,471	10,104	46,566	-	119,644
Provision for bad debts	-	32,456	10,941	15,723	-	59,120
Equity in earnings of unconsolidated subsidiaries	-	(15,555)	(63)	-	-	(15,618)
Equity in earnings of consolidated subsidiaries	(75,348)	(10,174)	-	-	85,522 (a)	-
Loss on extinguishment of debt	6,527	-	-	-	-	6,527
Loss (gain) on sale or disposal of assets and businesses	(8)	(4,824)	(4,687)	20	-	(9,499)
Stock compensation expense	13,445	-	-	782	-	14,227
Amortization of debt discount, premium and issuance costs	6,113	-	-	2,433	-	8,546
Deferred income taxes	5,014	-	-	(11,140)	-	(6,126)
Changes in operating assets and liabilities, net of effects of business combinations:						
Accounts receivable	-	(137,255)	(33,634)	(30,625)	-	(201,514)
Other current assets	1,016	3,816	(6,731)	(778)	-	(2,677)
Other assets	1,633	(3,709)	3,044	439	-	1,407
Accounts payable	2,375	(616)	1,373	781	-	3,913
Accrued expenses	164	(2,075)	11,181	9,482	-	18,752
Income taxes	3,776	-	-	15,365	-	19,141
Net cash provided by (used in) operating activities	<u>46,597</u>	<u>(6,533)</u>	<u>5,448</u>	<u>84,460</u>	<u>-</u>	<u>129,972</u>
Investing activities						
Business combinations, net of cash acquired	-	(3,356)	(295)	(15,720)	-	(19,371)
Purchases of property and equipment	(26,350)	(102,150)	(23,644)	(21,656)	-	(173,800)
Investment in businesses	-	(11,374)	-	-	-	(11,374)
Proceeds from sale of assets and businesses	8	15,007	19,537	3	-	34,555
Net cash used in investing activities	<u>(26,342)</u>	<u>(101,873)</u>	<u>(4,402)</u>	<u>(37,373)</u>	<u>-</u>	<u>(169,990)</u>
Financing activities						
Borrowings on revolving facilities	805,000	-	-	-	-	805,000
Payments on revolving facilities	(705,000)	-	-	-	-	(705,000)
Proceeds from term loans	1,139,487	-	-	-	-	1,139,487
Payments on term loans	(1,153,502)	-	-	(23,065)	-	(1,176,567)
Revolving facility debt issuance costs	(4,392)	-	-	-	-	(4,392)
Borrowings of other debt	21,572	-	3,232	2,767	-	27,571
Principal payments on other debt	(10,122)	(306)	(2,150)	(2,534)	-	(15,112)
Dividends paid to Holdings	(3,603)	-	-	-	-	(3,603)
Equity investment by Holdings	1,634	-	-	-	-	1,634
Intercompany	(101,888)	108,724	(6,836)	-	-	-
Proceeds from issuance of non-controlling interests	-	-	8,986	-	-	8,986
Repayments of overdrafts	(20,439)	-	-	-	-	(20,439)
Purchase of non-controlling interests	-	(120)	-	-	-	(120)
Distributions to non-controlling interests	-	-	(4,786)	(4,370)	-	(9,156)
Net cash provided by (used in) financing activities	<u>(31,253)</u>	<u>108,298</u>	<u>(1,554)</u>	<u>(27,202)</u>	<u>-</u>	<u>48,289</u>
Net increase (decrease) in cash and cash equivalents	(10,998)	(108)	(508)	19,885	-	8,271
Cash and cash equivalents at beginning of period	<u>11,071</u>	<u>6,467</u>	<u>5,056</u>	<u>76,435</u>	<u>-</u>	<u>99,029</u>
Cash and cash equivalents at end of period	<u>\$ 73</u>	<u>\$ 6,359</u>	<u>\$ 4,548</u>	<u>\$ 96,320</u>	<u>\$ -</u>	<u>\$ 107,300</u>

(a) Elimination of equity in earnings of consolidated subsidiaries.

Select Medical Corporation
Condensed Consolidating Balance Sheet
December 31, 2016
(b) (c) (d) (e)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Consolidating and Eliminating Adjustments	Consolidated Select Medical Corporation					
	(in thousands)										
Assets											
Current Assets:											
Cash and cash equivalents	\$ 11,071	\$ 6,467	\$ 5,056	\$ 76,435	\$ -	\$ 99,029					
Accounts receivable, net	-	363,470	97,770	112,512	-	573,752					
Intercompany receivables	-	1,573,960	25,578	-	(1,599,538) (a)	-					
Prepaid income taxes	6,658	-	-	5,765	-	12,423					
Other current assets	11,953	33,958	10,269	21,519	-	77,699					
Total Current Assets	29,682	1,977,855	138,673	216,231	(1,599,538)	762,903					
Property and equipment, net	48,697	603,408	50,869	189,243	-	892,217					
Investment in affiliates	4,493,684	89,288	-	-	(4,582,972) (b) (c)	-					
Goodwill	-	2,090,963	-	660,037	-	2,751,000					
Identifiable intangible assets, net	-	106,439	2,693	231,430	-	340,562					
Other assets	45,636	84,803	53,954	16,235	(26,684) (e)	173,944					
Total Assets	\$ 4,617,699	\$ 4,952,756	\$ 246,189	\$ 1,313,176	\$ (6,209,194)	\$ 4,920,626					
Liabilities and Equity											
Current Liabilities:											
Overdrafts	\$ 39,362	\$ -	\$ -	\$ -	\$ -	\$ 39,362					
Current portion of long-term debt and notes payable	7,227	445	1,324	4,660	-	13,656					
Accounts payable	10,775	78,608	22,397	14,778	-	126,558					
Intercompany payables	1,573,960	25,578	-	-	(1,599,538) (a)	-					
Accrued payroll	16,963	92,216	4,246	32,972	-	146,397					
Accrued vacation	3,440	55,486	10,668	13,667	-	83,261					
Accrued interest	20,114	-	-	2,211	-	22,325					
Accrued other	39,155	62,384	4,639	33,898	-	140,076					
Total Current Liabilities	1,710,996	314,717	43,274	102,186	(1,599,538)	571,635					
Long-term debt, net of current portion	2,048,154	601	9,685	626,893	-	2,685,333					
Non-current deferred tax liability	-	133,852	596	91,314	(26,684) (e)	199,078					
Other non-current liabilities	42,824	53,537	5,727	34,432	-	136,520					
Total Liabilities	3,801,974	502,707	59,282	854,825	(1,626,222)	3,592,566					
Redeemable non-controlling interests	-	-	-	15,493	406,666 (d)	422,159					
Stockholder's Equity:											
Common stock	0	-	-	-	-	0					
Capital in excess of par	925,111	-	-	-	-	925,111					
Retained earnings (accumulated deficit)	(109,386)	1,269,009	(32,826)	2,723	(1,238,906) (c) (d)	(109,386)					
Subsidiary investment	-	3,181,040	219,733	436,786	(3,837,559) (b) (d)	-					
Total Select Medical Corporation Stockholder's Equity	815,725	4,450,049	186,907	439,509	(5,076,465)	815,725					
Non-controlling interests	-	-	-	3,349	86,827 (d)	90,176					
Total Equity	815,725	4,450,049	186,907	442,858	(4,989,638)	905,901					
Total Liabilities and Equity	\$ 4,617,699	\$ 4,952,756	\$ 246,189	\$ 1,313,176	\$ (6,209,194)	\$ 4,920,626					

- (a) Elimination of intercompany balances.
- (b) Elimination of investments in consolidated subsidiaries.
- (c) Elimination of investments in consolidated subsidiaries' earnings.
- (d) Reclassification of equity attributable to non-controlling interests.
- (e) Reclassification of non-current deferred tax asset to report net non-current deferred tax liability in consolidation.

Select Medical Corporation
Condensed Consolidating Statement of Operations
For the Three Months Ended September 30, 2016
(b) (unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Consolidating and Eliminating Adjustments	Consolidated Select Medical Corporation
(in thousands)						
Net operating revenues	\$ 85	\$ 655,663	\$ 139,540	\$ 258,507	\$ -	\$ 1,053,795
Costs and expenses:						
Cost of services	626	569,167	133,480	212,430	-	915,703
General and administrative	26,967	121	-	-	-	27,088
Bad debt expense	-	9,662	2,633	5,382	-	17,677
Depreciation and amortization	1,411	17,335	3,141	15,278	-	37,165
Total costs and expenses	29,004	596,285	139,254	233,090	-	997,633
Income (loss) from operations	(28,919)	59,378	286	25,417	-	56,162
Other income and expense:						
Intercompany interest and royalty fees	8,458	(4,884)	(3,574)	-	-	-
Intercompany management fees	33,693	(25,880)	(7,813)	-	-	-
Loss on early retirement of debt	-	-	-	(10,853)	-	(10,853)
Equity in earnings of unconsolidated subsidiaries	-	5,238	30	-	-	5,268
Non-operating gain (loss)	(6,963)	5,935	-	-	-	(1,028)
Interest income (expense)	(34,424)	137	(31)	(10,164)	-	(44,482)
Income (loss) before income taxes	(28,155)	39,924	(11,102)	4,400	-	5,067
Income tax expense (benefit)	5,701	(7,284)	1,484	1,174	-	1,075
Equity in earnings (losses) of consolidated subsidiaries	40,327	(7,877)	-	-	(32,450)	(a) -
Net income (loss)	6,471	39,331	(12,586)	3,226	(32,450)	3,992
Less: Net income (loss) attributable to non-controlling interests	-	(6)	(4,804)	2,331	-	(2,479)
Net income (loss) attributable to Select Medical Corporation	\$ 6,471	\$ 39,337	\$ (7,782)	\$ 895	\$ (32,450)	\$ 6,471

(a) Elimination of equity in earnings of consolidated subsidiaries.

Select Medical Corporation
Condensed Consolidating Statement of Operations
For the Nine Months Ended September 30, 2016
(b) (unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Consolidating and Eliminating Adjustments	Consolidated Select Medical Corporation
(in thousands)						
Net operating revenues	\$ 522	\$ 2,095,102	\$ 379,880	\$ 764,252	\$ -	\$ 3,239,756
Costs and expenses:						
Cost of services	1,576	1,780,606	340,254	632,514	-	2,754,950
General and administrative	81,198	28	-	-	-	81,226
Bad debt expense	-	30,665	6,691	14,235	-	51,591
Depreciation and amortization	3,898	49,983	8,436	45,570	-	107,887
Total costs and expenses	<u>86,672</u>	<u>1,861,282</u>	<u>355,381</u>	<u>692,319</u>	<u>-</u>	<u>2,995,654</u>
Income (loss) from operations	(86,150)	233,820	24,499	71,933	-	244,102
Other income and expense:						
Intercompany interest and royalty fees	22,793	(12,314)	(10,479)	-	-	-
Intercompany management fees	127,832	(108,007)	(19,825)	-	-	-
Loss on early retirement of debt	(773)	-	-	(10,853)	-	(11,626)
Equity in earnings of unconsolidated subsidiaries	-	14,384	82	-	-	14,466
Non-operating gain	33,932	3,162	-	-	-	37,094
Interest income (expense)	(97,239)	293	(71)	(30,645)	-	(127,662)
Income (loss) before income taxes	395	131,338	(5,794)	30,435	-	156,374
Income tax expense	13,840	24,701	2,091	10,953	-	51,585
Equity in earnings (losses) of consolidated subsidiaries	<u>108,684</u>	<u>(6,004)</u>	<u>-</u>	<u>(102,680)</u>	(a)	<u>-</u>
Net income (loss)	<u>95,239</u>	<u>100,606</u>	<u>(5,776)</u>	<u>7,850</u>	<u>\$ (102,680)</u>	<u>104,789</u>
Less: Net income (loss) attributable to non-controlling interests	-	27	(2,109)	11,632	-	9,550
Net income (loss) attributable to Select Medical Corporation	<u>\$ 95,239</u>	<u>\$ 100,606</u>	<u>\$ (5,776)</u>	<u>\$ 7,850</u>	<u>\$ (102,680)</u>	<u>\$ 95,239</u>

(a) Elimination of equity in earnings of consolidated subsidiaries.

Select Medical Corporation
Condensed Consolidating Statement of Cash Flows
For the Nine Months Ended September 30, 2016
(b unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Consolidating and Eliminating Adjustments	Consolidated Select Medical Corporation
(in thousands)						
Operating activities						
Net income	\$ 95,239	\$ 100,633	\$ (7,885)	\$ 19,482	\$ (102,680) (a)	\$ 104,789
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Distributions from unconsolidated subsidiaries	-	16,075	70	-	-	16,145
Depreciation and amortization	3,898	49,983	8,436	45,570	-	107,887
Provision for bad debts	-	30,665	6,691	14,235	-	51,591
Equity in earnings of unconsolidated subsidiaries	-	(14,384)	(82)	-	-	(14,466)
Equity in earnings of consolidated subsidiaries	(108,684)	6,004	-	-	102,680 (a)	-
Loss on extinguishment of debt	773	-	-	10,853	-	11,626
Loss (gain) on sale or disposal of assets and businesses	(33,707)	(8,367)	185	(21)	-	(41,910)
Gain on sale of equity investment	-	(241)	-	-	-	(241)
Impairment of equity investment	-	5,339	-	-	-	5,339
Stock compensation expense	12,347	-	-	577	-	12,924
Amortization of debt discount, premium and issuance costs	9,289	-	-	2,556	-	11,845
Deferred income taxes	(902)	-	-	(12,186)	-	(13,088)
Changes in operating assets and liabilities, net of effects of business combinations:						
Accounts receivable	-	6,288	(27,966)	(19,098)	-	(40,776)
Other current assets	(1,153)	9,745	(6,113)	9,615	-	12,094
Other assets	(3,881)	53,100	(53,961)	9,888	-	5,146
Accounts payable	(239)	(22,529)	487	4,529	-	(17,752)
Accrued expenses	19,692	36,051	(214)	(2,533)	-	52,996
Due to third party payors	-	15,019	(3,954)	-	-	11,065
Income taxes	3,230	-	-	2,317	-	5,547
Net cash provided by (used in) operating activities	(4,098)	283,381	(84,306)	85,784	-	280,761
Investing activities						
Business combinations, net of cash acquired	(406,305)	(3,523)	-	(4,403)	-	(414,231)
Purchases of property and equipment	(13,315)	(68,609)	(25,689)	(10,647)	-	(118,260)
Investment in businesses	-	(3,140)	-	-	-	(3,140)
Proceeds from sale of assets, businesses, and equity investment	63,418	9,205	6	-	-	72,629
Net cash used in investing activities	(356,202)	(66,067)	(25,683)	(15,050)	-	(463,002)
Financing activities						
Borrowings on revolving facilities	420,000	-	-	-	-	420,000
Payments on revolving facilities	(540,000)	-	-	(5,000)	-	(545,000)
Proceeds from term loans	600,127	-	-	195,217	-	795,344
Payments on term loans	(228,962)	-	-	(205,880)	-	(434,842)
Borrowings of other debt	8,748	-	12,237	2,816	-	23,801
Principal payments on other debt	(10,971)	(528)	(1,813)	(2,165)	-	(15,477)
Dividends paid to Holdings	(1,939)	-	-	-	-	(1,939)
Equity investment by Holdings	1,488	-	-	-	-	1,488
Intercompany	116,274	(214,053)	97,779	-	-	-
Proceeds from issuance of non-controlling interests	-	-	11,846	-	-	11,846
Repayments of overdrafts	(8,464)	-	-	-	-	(8,464)
Purchase of non-controlling interests	-	(1,530)	-	-	-	(1,530)
Distributions to non-controlling interests	-	(217)	(6,545)	(2,436)	-	(9,198)
Net cash provided by (used in) financing activities	356,301	(216,328)	113,504	(17,448)	-	236,029
Net increase (decrease) in cash and cash equivalents	(3,999)	986	3,515	53,286	-	53,788
Cash and cash equivalents at beginning of period	4,070	3,706	625	6,034	-	14,435
Cash and cash equivalents at end of period	\$ 71	\$ 4,692	\$ 4,140	\$ 59,320	\$ -	\$ 68,223

(a) Elimination of equity in earnings of consolidated subsidiaries.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read this discussion together with our unaudited condensed consolidated financial statements and accompanying notes.

Forward-Looking Statements

This report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements include statements preceded by, followed by or that include the words "may," "could," "would," "should," "believe," "expect," "anticipate," "plan," "target," "estimate," "project," "intend," and similar expressions. These statements include, among others, statements regarding our expected business outlook, anticipated financial and operating results, our business strategy and means to implement our strategy, our objectives, the amount and timing of capital expenditures, the likelihood of our success in expanding our business, financing plans, budgets, working capital needs, and sources of liquidity.

Forward-looking statements are only predictions and are not guarantees of performance. These statements are based on our management's beliefs and assumptions, which in turn are based on currently available information. Important assumptions relating to the forward-looking statements include, among others, assumptions regarding our services, the expansion of our services, competitive conditions, and general economic conditions. These assumptions could prove inaccurate. Forward-looking statements also involve known and unknown risks and uncertainties, which could cause actual results to differ materially from those contained in any forward-looking statement. Many of these factors are beyond our ability to control or predict. Such factors include, but are not limited to, the following:

- changes in government reimbursement for our services due to the implementation of healthcare reform legislation, deficit reduction measures, and/or new payment policies (including, for example, the expiration of the moratorium limiting the full application of the 25 Percent Rule that would reduce our Medicare payments for those patients admitted to a long term acute care hospital from a referring hospital in excess of an applicable percentage admissions threshold) may result in a reduction in net operating revenues, an increase in costs, and a reduction in profitability;
- the impact of the Bipartisan Budget Act of 2013 (the "BBA of 2013"), which established payment limits for Medicare patients who do not meet specified criteria, may result in a reduction in net operating revenues and profitability of our long term acute care hospitals ("LTCHs");
- the failure of our specialty hospitals to maintain their Medicare certifications may cause our net operating revenues and profitability to decline;
- the failure of our facilities operated as "hospitals within hospitals" to qualify as hospitals separate from their host hospitals may cause our net operating revenues and profitability to decline;
- a government investigation or assertion that we have violated applicable regulations may result in sanctions or reputational harm and increased costs;
- acquisitions or joint ventures may prove difficult or unsuccessful, use significant resources, or expose us to unforeseen liabilities;
- our plans and expectations related to the pending acquisition of U.S. HealthWorks and our ability to realize anticipated synergies;
- private third-party payors for our services may adopt payment policies that could limit our future net operating revenues and profitability;
- the failure to maintain established relationships with the physicians in the areas we serve could reduce our net operating revenues and profitability;

- shortages in qualified nurses, therapists, physicians, or other licensed providers could increase our operating costs significantly or limit our ability to staff our facilities;
- competition may limit our ability to grow and result in a decrease in our net operating revenues and profitability;
- the loss of key members of our management team could significantly disrupt our operations;
- the effect of claims asserted against us could subject us to substantial uninsured liabilities; and
- other factors discussed from time to time in our filings with the SEC, including factors discussed under the heading “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2016, as such risk factors may be updated from time to time in our periodic filings with the SEC.

Except as required by applicable law, including the securities laws of the United States and the rules and regulations of the SEC, we are under no obligation to publicly update or revise any forward-looking statements, whether as a result of any new information, future events, or otherwise. You should not place undue reliance on our forward-looking statements. Although we believe that the expectations reflected in forward-looking statements are reasonable, we cannot guarantee future results or performance.

Investors should also be aware that while we do, from time to time, communicate with securities analysts, it is against our policy to disclose to securities analysts any material non-public information or other confidential commercial information. Accordingly, stockholders should not assume that we agree with any statement or report issued by any securities analyst irrespective of the content of the statement or report. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not the responsibility of the Company.

Overview

We began operations in 1997 and, based on number of facilities, are one of the largest operators of specialty hospitals, outpatient rehabilitation clinics, and occupational medicine centers in the United States. As of September 30, 2017, we had operations in 46 states and the District of Columbia. As of September 30, 2017, we operated 123 specialty hospitals in 28 states and 1,604 outpatient rehabilitation clinics in 37 states and the District of Columbia. Concentra, which is operated through a joint venture subsidiary, operated 312 medical centers in 38 states as of September 30, 2017. Concentra also provides contract services at employer worksites and Department of Veterans Affairs community-based outpatient clinics, or “CBOCs.”

We manage our Company through three business segments: specialty hospitals, outpatient rehabilitation, and Concentra. We had net operating revenues of \$3,329.2 million for the nine months ended September 30, 2017. Of this total, we earned approximately 54% of our net operating revenues from our specialty hospitals segment, approximately 23% from our outpatient rehabilitation segment, and approximately 23% from our Concentra segment. Patients are typically admitted to our specialty hospitals from general acute care hospitals. These patients have specialized needs, with serious and often complex medical conditions. Our outpatient rehabilitation segment consists of clinics that provide physical, occupational, and speech rehabilitation services. Our Concentra segment consists of medical centers and contract services provided at employer worksites and Department of Veterans Affairs CBOCs that deliver occupational medicine, physical therapy, veteran’s healthcare, and consumer health services.

Non-GAAP Measure

We believe that the presentation of Adjusted EBITDA is important to investors because Adjusted EBITDA is commonly used as an analytical indicator of performance by investors within the healthcare industry. Adjusted EBITDA is used by management to evaluate financial performance and determine resource allocation for each of our operating segments. Adjusted EBITDA is not a measure of financial performance under accounting principles generally accepted in the United States of America (“GAAP”). Items excluded from Adjusted EBITDA are significant components in understanding and assessing financial performance. Adjusted EBITDA should not be considered in isolation or as an alternative to, or substitute for, net income, income from operations, cash flows generated by operations, investing or financing activities, or other financial statement data presented in the consolidated financial statements as indicators of financial performance or liquidity. Because Adjusted EBITDA is not a measurement determined in accordance with GAAP and is thus susceptible to varying calculations, Adjusted EBITDA as presented may not be comparable to other similarly titled measures of other companies.

We define Adjusted EBITDA as earnings excluding interest, income taxes, depreciation and amortization, gain (loss) on early retirement of debt, stock compensation expense, Physiotherapy acquisition costs, non-operating gain (loss), and equity in earnings (losses) of unconsolidated subsidiaries. We will refer to Adjusted EBITDA throughout the remainder of Management's Discussion and Analysis of Financial Condition and Results of Operations.

The table below reconciles net income and income from operations to Adjusted EBITDA and should be referenced when we discuss Adjusted EBITDA.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2017	2016	2017
Net income	\$ 3,992	\$ 24,824	\$ 104,789	\$ 99,587
Income tax expense	1,075	14,017	51,585	59,593
Interest expense	44,482	37,688	127,662	116,196
Non-operating loss (gain)	1,028	—	(37,094)	49
Equity in earnings of unconsolidated subsidiaries	(5,268)	(4,431)	(14,466)	(15,618)
Loss on early retirement of debt	10,853	—	11,626	19,719
Income from operations	56,162	72,098	244,102	279,526
Stock compensation expense:				
Included in general and administrative	3,932	4,079	10,771	11,603
Included in cost of services	818	878	2,153	2,624
Depreciation and amortization	37,165	38,772	107,887	119,644
Physiotherapy acquisition costs	—	—	3,236	—
Adjusted EBITDA	<u>\$ 98,077</u>	<u>\$ 115,827</u>	<u>\$ 368,149</u>	<u>\$ 413,397</u>

Summary Financial Results

Three Months Ended September 30, 2017

For the three months ended September 30, 2017, our net operating revenues increased 4.1% to \$1,097.2 million, compared to \$1,053.8 million for the three months ended September 30, 2016. Income from operations increased 28.4% to \$72.1 million for the three months ended September 30, 2017, compared to \$56.2 million for the three months ended September 30, 2016. Net income increased to \$24.8 million for the three months ended September 30, 2017, compared to \$4.0 million for the three months ended September 30, 2016. Net income for the three months ended September 30, 2016 included a pre-tax loss on early retirement of debt of \$10.9 million and a pre-tax non-operating loss of \$1.0 million. Our Adjusted EBITDA increased 18.1% to \$115.8 million for the three months ended September 30, 2017, compared to \$98.1 million for the three months ended September 30, 2016. Our Adjusted EBITDA margin was 10.6% for the three months ended September 30, 2017, compared to 9.3% for the three months ended September 30, 2016.

Nine Months Ended September 30, 2017

For the nine months ended September 30, 2017, our net operating revenues increased 2.8% to \$3,329.2 million, compared to \$3,239.8 million for the nine months ended September 30, 2016. Income from operations increased 14.5% to \$279.5 million for the nine months ended September 30, 2017, compared to \$244.1 million for the nine months ended September 30, 2016. Net income was \$99.6 million for the nine months ended September 30, 2017, which includes pre-tax losses on early retirement of debt of \$19.7 million. Net income was \$104.8 million for the nine months ended September 30, 2016, which included pre-tax non-operating gains of \$37.1 million and pre-tax losses on early retirement of debt of \$11.6 million. Our Adjusted EBITDA increased 12.3% to \$413.4 million for the nine months ended September 30, 2017, compared to \$368.1 million for the nine months ended September 30, 2016. Our Adjusted EBITDA margin was 12.4% for the nine months ended September 30, 2017, compared to 11.4% for the nine months ended September 30, 2016.

Implementation of Patient Criteria

As discussed below under "Regulatory Changes – Medicare Reimbursement of LTCH Services – Patient Criteria," our LTCHs transitioned to new Medicare regulations, which established payment limits for Medicare patients discharged from an LTCH who do not meet specified patient criteria, beginning October 1, 2015. Since completing our transition to the new LTCH Medicare patient criteria regulations during the third quarter of 2016, we have experienced an increase in admissions of patients eligible for the full LTCH-PPS standard reimbursement rate.

The table below illustrates the trends of our case mix index and occupancy percentages during the periods in which our LTCHs became subject to the new patient criteria requirements.

	2015		2016		2017	
	Occupancy Percentage	Case Mix Index ⁽¹⁾	Occupancy Percentage	Case Mix Index ⁽¹⁾	Occupancy Percentage	Case Mix Index ⁽¹⁾
Three months ended:						
March 31	71%	1.22	71%	1.24	68%	1.28
June 30	70%	1.21	67%	1.27	66%	1.28
September 30	70%	1.18	61%	1.26	65%	1.27
December 31	70%	1.21	63%	1.26		

- (1) Case mix index, which is calculated as the sum of all diagnostic-related group weights for the period divided by the sum of discharges for the same period, is reflective of the level of patient-acuity in our LTCHs.

From 2015 to 2017, our case mix index has increased, which is reflective of the higher-acuity patients we are now admitting under patient criteria. This has resulted in increases in our net revenue per patient day due to higher reimbursement rates for these cases. Our LTCH occupancy percentage reached its lowest level during the third quarter of 2016, which is the first quarter in which all of our LTCHs operated under the new Medicare payment rules.

Significant Events

Refinancing

On March 6, 2017, Select entered into a new senior secured credit agreement that provides for \$1.6 billion in senior secured credit facilities comprising a \$1.15 billion, seven-year term loan and a \$450.0 million, five-year revolving credit facility, including a \$75.0 million sublimit for the issuance of standby letters of credit. Select used borrowings under the new Select credit facilities to: (i) repay the series E tranche B term loans due June 1, 2018, the series F tranche B term loans due March 31, 2021, and the revolving facility maturing March 1, 2018 under Select's 2011 senior secured credit facility; and (ii) pay fees and expenses in connection with the refinancing.

Pending Acquisition of U.S. HealthWorks

On October 23, 2017, Select announced that Concentra Group Holdings entered into a Purchase Agreement dated October 22, 2017 with Concentra, Group Holdings Parent, U.S. HealthWorks, and DHHC. Pursuant to the terms of the Purchase Agreement, Concentra will acquire the issued and outstanding shares of stock of U.S. HealthWorks, an occupational medicine and urgent care service provider.

In connection with the closing of the transaction, it is expected that Concentra Group Holdings will redeem certain of its outstanding equity interests from existing minority equity holders and subsequently, Concentra Group Holdings and a wholly owned subsidiary of Group Holdings Parent will merge, with Concentra Group Holdings surviving the merger and becoming a wholly owned subsidiary of Group Holdings Parent. As a result of the merger, the equity interests of Concentra Group Holdings outstanding after the redemption described above will be exchanged for membership interests in Group Holdings Parent.

The transaction values U.S. HealthWorks at \$753.0 million, subject to certain customary adjustments for working capital, cash, debt, transaction expenses and other items in accordance with the terms of the Purchase Agreement. DHHC, a subsidiary of Dignity Health, will be issued a 20% equity interest in Group Holdings Parent, which is valued at \$238.0 million. The remainder of the purchase price will be paid in cash. Select will retain a majority voting interest in Group Holdings Parent following the closing of the transaction.

Concentra expects to finance the transaction and related expenses using a proposed \$555.0 million senior secured incremental term facility under its existing credit facility and a proposed \$240.0 million second lien term facility, for which JP Morgan Chase, N.A. has provided Concentra with a debt commitment letter.

The transaction, which is expected to close in the first quarter of 2018, is subject to a number of closing conditions, including clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

Regulatory Changes

Our Annual Report on Form 10-K for the year ended December 31, 2016, filed with the SEC on February 23, 2017, contains a detailed discussion of the regulations that affect our business in Part I — Business — Government Regulations. The following is a discussion of some of the more significant healthcare regulatory changes that have affected our financial performance in the periods covered by this report or are likely to affect our financial performance and financial condition in the future. The information below should be read in conjunction with the more detailed discussion of regulations contained in our Form 10-K.

Medicare Reimbursement

The Medicare program reimburses healthcare providers for services furnished to Medicare beneficiaries, which are generally persons age 65 and older, those who are chronically disabled, and those suffering from end stage renal disease. The program is governed by the Social Security Act of 1965 and is administered primarily by the Department of Health and Human Services and CMS. Net operating revenues generated directly from the Medicare program represented approximately 30% of our net operating revenues for both the nine months ended September 30, 2017 and the year ended December 31, 2016.

Medicare Reimbursement of LTCH Services

There have been significant regulatory changes affecting LTCHs that have affected our net operating revenues and, in some cases, caused us to change our operating models and strategies. We have been subject to regulatory changes that occur through the rulemaking procedures of CMS. All Medicare payments to our LTCHs are made in accordance with the long term care hospital prospective payment system (“LTCH-PPS”). Proposed rules specifically related to LTCHs are generally published in April or May, finalized in August, and effective on October 1st of each year.

The following is a summary of significant changes to the Medicare prospective payment system for LTCHs which have affected our financial performance in the periods covered by this report or may affect our financial performance and financial condition in the future.

Fiscal Year 2016. On August 17, 2015, CMS published the final rule updating policies and payment rates for the LTCH-PPS for fiscal year 2016 (affecting discharges and cost reporting periods beginning on or after October 1, 2015 through September 30, 2016). The standard federal rate was set at \$41,763, an increase from the standard federal rate applicable during fiscal year 2015 of \$41,044. The update to the standard federal rate for fiscal year 2016 included a market basket increase of 2.4%, less a productivity adjustment of 0.5%, and less a reduction of 0.2% mandated by the Affordable Care Act (“ACA”). The fixed loss amount for high cost outlier cases paid under LTCH-PPS was set at \$16,423, an increase from the fixed loss amount in the 2015 fiscal year of \$14,972. The fixed loss amount for high cost outlier cases paid under the site neutral payment rate described below was set at \$22,538.

Fiscal Year 2017. On August 22, 2016, CMS published the final rule updating policies and payment rates for the LTCH-PPS for fiscal year 2017 (affecting discharges and cost reporting periods beginning on or after October 1, 2016 through September 30, 2017). The standard federal rate was set at \$42,476, an increase from the standard federal rate applicable during fiscal year 2016 of \$41,763. The update to the standard federal rate for fiscal year 2017 included a market basket increase of 2.8%, less a productivity adjustment of 0.3%, and less a reduction of 0.75% mandated by the ACA. The fixed-loss amount for high cost outlier cases paid under LTCH-PPS was set at \$21,943, an increase from the fixed-loss amount in the 2016 fiscal year of \$16,423. The fixed-loss amount for high cost outlier cases paid under the site-neutral payment rate was set at \$23,573, an increase from the fixed-loss amount in the 2016 fiscal year of \$22,538.

Fiscal Year 2018. On August 14, 2017, CMS published the final rule updating policies and payment rates for the LTCH-PPS for fiscal year 2018 (affecting discharges and cost reporting periods beginning on or after October 1, 2017 through September 30, 2018). Certain errors in the final rule were corrected in a final rule published October 4, 2017. The standard federal rate was set at \$41,415, a decrease from the standard federal rate applicable during fiscal year 2017 of \$42,476. The update to the standard federal rate for fiscal year 2018 included a market basket increase of 2.7%, less a productivity adjustment of 0.6%, and less a reduction of 0.75% mandated by the ACA. As noted below, the update to the standard federal rate for fiscal year 2018 is impacted further by the Medicare Access and CHIP Reauthorization Act of 2015, which limits the update for fiscal year 2018 to 1.0%. The fixed-loss amount for high cost outlier cases paid under LTCH-PPS was set at \$27,381, an increase from the fixed-loss amount in the 2017 fiscal year of \$21,943. The fixed-loss amount for high cost outlier cases paid under the site-neutral payment rate was set at \$26,537, an increase from the fixed-loss amount in the 2017 fiscal year of \$23,573.

Patient Criteria

The BBA of 2013, enacted December 26, 2013, establishes a dual-rate LTCH-PPS for Medicare patients discharged from an LTCH. Specifically, for Medicare patients discharged in cost reporting periods beginning on or after October 1, 2015, LTCHs will be reimbursed at the LTCH-PPS standard federal payment rate only if, immediately preceding the patient's LTCH admission, the patient was discharged from a "subsection (d) hospital" (generally, a short-term acute care hospital paid under the inpatient prospective payment system, or "IPPS") and either the patient's stay included at least three days in an intensive care unit (ICU) or coronary care unit (CCU) at the subsection (d) hospital, or the patient was assigned to Medicare severity diagnosis-related group ("MS-LTC-DRG") for LTCHs for cases receiving at least 96 hours of ventilator services in the LTCH. In addition, to be paid at the LTCH-PPS standard federal payment rate, the patient's discharge from the LTCH may not include a principal diagnosis relating to psychiatric or rehabilitation services. For any Medicare patient who does not meet these criteria, the LTCH will be paid a lower "site neutral" payment rate, which will be the lower of: (i) IPPS comparable per diem payment rate capped at the Medicare severity diagnosis-related group ("MS-DRG") payment rate plus any outlier payments; or (ii) 100 percent of the estimated costs for services.

The BBA of 2013 provides for a transition to the site-neutral payment rate for those patients not paid at the LTCH-PPS standard federal payment rate. During the transition period (applicable to hospital cost reporting periods beginning on or after October 1, 2015 and on or before September 30, 2017), a blended rate will be paid for Medicare patients not meeting the new criteria that is equal to 50% of the site-neutral payment rate amount and 50% of the standard federal payment rate amount. For discharges in cost reporting periods beginning on or after October 1, 2017, only the site-neutral payment rate will apply for Medicare patients not meeting the new criteria.

In addition, for cost reporting periods beginning on or after October 1, 2019, qualifying discharges from an LTCH will continue to be paid at the LTCH-PPS standard federal payment rate, unless the number of discharges for which payment is made under the site-neutral payment rate is greater than 50% of the total number of discharges from the LTCH for that period. If the number of discharges for which payment is made under the site-neutral payment rate is greater than 50%, then beginning in the next cost reporting period all discharges from the LTCH will be reimbursed at the site-neutral payment rate. The BBA of 2013 requires CMS to establish a process for an LTCH subject to only the site-neutral payment rate to be reinstated for payment under the dual-rate LTCH-PPS.

Payment adjustments, including the interrupted stay policy and the 25 Percent Rule (discussed below), apply to LTCH discharges regardless of whether the case is paid at the standard federal payment rate or the site-neutral payment rate. However, short stay outlier payment adjustments do not apply to cases paid at the site-neutral payment rate. CMS calculates the annual recalibration of the MS-LTC-DRG relative payment weighting factors using only data from LTCH discharges that meet the criteria for exclusion from the site-neutral payment rate. In addition, CMS applies the IPPS fixed-loss amount for high cost outliers to site-neutral cases, rather than the LTCH-PPS fixed-loss amount. CMS calculates the LTCH-PPS fixed-loss amount using only data from cases paid at the LTCH-PPS payment rate, excluding cases paid at the site-neutral rate.

Medicare Market Basket Adjustments

The ACA instituted a market basket payment adjustment to LTCHs. In fiscal years 2018 and 2019, the market basket update will be reduced by 0.75%. The Medicare Access and CHIP Reauthorization Act of 2015 sets the annual update for fiscal year 2018 at 1% after taking into account the market basket payment reduction of 0.75% mandated by the ACA. The ACA specifically allows these market basket reductions to result in less than a 0% payment update and payment rates that are less than the prior year.

25 Percent Rule

The "25 Percent Rule" is a downward payment adjustment that applies if the percentage of Medicare patients discharged from LTCHs who were admitted from a referring hospital (regardless of whether the LTCH or LTCH satellite is co-located with the referring hospital) exceeds the applicable percentage admissions threshold during a particular cost reporting period. For Medicare patients above the applicable percentage admissions threshold, the LTCH is reimbursed at a rate equivalent to that under general acute care hospital IPPS, which is generally lower than LTCH-PPS rates. Cases that reach outlier status in the referring hospital do not count toward the admissions threshold and are paid under LTCH-PPS.

Current law, as amended by the 21st Century Cures Act, precludes CMS from applying the 25 Percent Rule for freestanding LTCHs to cost reporting years beginning before July 1, 2016 and for discharges occurring on or after October 1, 2016 and before October 1, 2017. In addition, current law applies higher percentage admissions thresholds under the 25 Percent Rule for most hospitals within hospitals (“HIHs”) for cost reporting years beginning before July 1, 2016 and effective for discharges occurring on or after October 1, 2016 and before October 1, 2017. For freestanding LTCHs the percentage admissions threshold is suspended during the relief periods. For HIHs the percentage admissions threshold is raised from 25% to 50% during the relief periods. In the special case of rural LTCHs, LTCHs co-located with an urban single hospital, or LTCHs co-located with a Metropolitan Statistical Area (“MSA”) dominant hospital the referral percentage was raised from 50% to 75%. Grandfathered HIHs are exempt from the 25 Percent Rule regulations.

For fiscal year 2018, CMS adopted a regulatory moratorium on the implementation of the 25 Percent Rule. As a result, the 25 Percent Rule applies to discharges occurring on or after October 1, 2018. After the expiration of the regulatory moratorium, our LTCHs (whether freestanding, HIH or satellite) will be subject to a downward payment adjustment for any Medicare patients who were admitted from a co-located or a non-co-located hospital and that exceed the applicable percentage admissions threshold of all Medicare patients discharged from the LTCH during the cost reporting period. These regulatory changes will have an adverse financial impact on the net operating revenues and profitability of many of these hospitals for discharges on or after October 1, 2018.

Short Stay Outlier Policy

CMS established a different payment methodology for Medicare patients with a length of stay less than or equal to five-sixths of the geometric average length of stay for that particular MS-LTC-DRG, referred to as a short stay outlier, or “SSO.” SSO cases are paid based on the lesser of (i) 100% of the average cost of the case, (ii) 120% of the MS-LTC-DRG specific per diem amount multiplied by the patient’s length of stay, (iii) the full MS-LTC-DRG payment, or (iv) a per diem rate derived from blending 120% of the MS-LTC-DRG specific per diem amount with a per diem rate based on the general acute care hospital IPPS.

For fiscal year 2018, CMS adopted changes to the SSO policy such that all SSO cases discharged on or after October 1, 2017 are paid based on a per diem rate derived from blending 120% of the MS-LTC-DRG specific per diem amount with a per diem rate based on the general acute care hospital IPPS. Under this policy, as the length of stay of a SSO case increases, the percentage of the per diem payment amounts based on the full MS-LTC-DRG standard federal payment rate increases and the percentage of the payment based on the IPPS comparable amount decreases.

Moratorium on New LTCHs, LTCH Satellite Facilities and LTCH beds

Current law imposes a moratorium on the establishment and classification of new LTCHs or LTCH satellite facilities, and on the increase of LTCH beds in existing LTCHs or satellite facilities through September 30, 2017. There are three exceptions to the moratorium for projects that were under development when the moratorium began on April 1, 2014. Only one exception needs to exist for the moratorium not to apply.

Medicare Reimbursement of Inpatient Rehabilitation Facility Services

The following is a summary of significant changes to the Medicare prospective payment system for inpatient rehabilitation facilities (“IRFs”) which have affected our financial performance in the periods covered by this report or may affect our financial performance and financial condition in the future. Medicare payments to our IRFs are made in accordance with the inpatient rehabilitation facility prospective payment system (“IRF-PPS”).

Fiscal Year 2016. On August 6, 2015, CMS published the final rule updating policies and payment rates for the IRF-PPS for fiscal year 2016 (affecting discharges and cost reporting periods beginning on or after October 1, 2015 through September 30, 2016). The standard payment conversion factor for discharges for fiscal year 2016 was set at \$15,478, an increase from the standard payment conversion factor applicable during fiscal year 2015 of \$15,198. The update to the standard payment conversion factor for fiscal year 2016 included a market basket increase of 2.4%, less a productivity adjustment of 0.5%, and less a reduction of 0.2% mandated by the ACA. CMS decreased the outlier threshold amount for fiscal year 2016 to \$8,658 from \$8,848 established in the final rule for fiscal year 2015.

Fiscal Year 2017. On August 5, 2016, CMS published the final rule updating policies and payment rates for the IRF-PPS for fiscal year 2017 (affecting discharges and cost reporting periods beginning on or after October 1, 2016 through September 30, 2017). The standard payment conversion factor for discharges for fiscal year 2017 was set at \$15,708, an increase from the standard payment conversion factor applicable during fiscal year 2016 of \$15,478. The update to the standard payment conversion factor for fiscal year 2017 included a market basket increase of 2.7%, less a productivity adjustment of 0.3%, and less a reduction of 0.75% mandated by the ACA. CMS decreased the outlier threshold amount for fiscal year 2017 to \$7,984 from \$8,658 established in the final rule for fiscal year 2016.

Fiscal Year 2018. On August 3, 2017, CMS published the final rule updating policies and payment rates for the IRF-PPS for fiscal year 2018 (affecting discharges and cost reporting periods beginning on or after October 1, 2017 through September 30, 2018). The standard payment conversion factor for discharges for fiscal year 2018 was set at \$15,838, an increase from the standard payment conversion factor applicable during fiscal year 2017 of \$15,708. The update to the standard payment conversion factor for fiscal year 2018 included a market basket increase of 2.6%, less a productivity adjustment of 0.6%, and less a reduction of 0.75% mandated by the ACA. As noted below, the standard payment conversion factor for fiscal year 2018 is impacted further by the Medicare Access and CHIP Reauthorization Act of 2015, which limits the update for fiscal year 2018 to 1.0%. CMS increased the outlier threshold amount for fiscal year 2018 to \$8,679 from \$7,984 established in the final rule for fiscal year 2017.

Medicare Market Basket Adjustments

The ACA instituted a market basket payment adjustment for IRFs. In fiscal years 2018 and 2019, the market basket update will be reduced by 0.75%. The Medicare Access and CHIP Reauthorization Act of 2015 sets the annual update for fiscal year 2018 at 1% after taking into account the market basket payment reduction of 0.75% mandated by the ACA. The ACA specifically allows these market basket reductions to result in less than a 0% payment update and payment rates that are less than the prior year.

Patient Classification Criteria

In order to qualify as an IRF a hospital must demonstrate that during its most recent twelve month cost reporting period it served an inpatient population of whom at least 60% required intensive rehabilitation services for one or more of 13 conditions specified by regulation. Compliance with the 60% rule is demonstrated through either medical review or the “presumptive” method, in which a patient’s diagnosis codes are compared to a “presumptive compliance” list. For fiscal year 2018, CMS revised the 60% rule’s presumptive methodology by (i) including certain International Classification of Diseases, Tenth Revision, Clinical Modification (“ICD-10-CM”) diagnosis codes for patients with traumatic brain injury and hip fracture conditions; and (ii) revising the presumptive methodology list for major multiple trauma by counting IRF cases that contain two or more of the ICD-10-CM codes from three major multiple trauma lists in the specified combinations.

Medicare Reimbursement of Outpatient Rehabilitation Services

The Medicare program reimburses outpatient rehabilitation providers based on the Medicare physician fee schedule. For services provided in 2017 through 2019, a 0.5% update will be applied each year to the fee schedule payment rates, subject to an adjustment beginning in 2019 under the Merit-Based Incentive Payment System (“MIPS”). For services provided in 2020 through 2025, a 0.0% percent update will be applied each year to the fee schedule payment rates, subject to adjustments under MIPS and the alternative payment models (“APMs”). In 2026 and subsequent years eligible professionals participating in APMs that meet certain criteria would receive annual updates of 0.75%, while all other professionals would receive annual updates of 0.25%.

Beginning in 2019, payments under the fee schedule are subject to adjustment based on performance in MIPS, which measures performance based on certain quality metrics, resource use, and meaningful use of electronic health records. Under the MIPS requirements a provider’s performance is assessed according to established performance standards and used to determine an adjustment factor that is then applied to the professional’s payment for a year. Each year from 2019 through 2024 professionals who receive a significant share of their revenues through an APM (such as accountable care organizations or bundled payment arrangements) that involves risk of financial losses and a quality measurement component will receive a 5% bonus. The bonus payment for APM participation is intended to encourage participation and testing of new APMs and to promote the alignment of incentives across payors. The specifics of the MIPS and APM adjustments beginning in 2019 and 2020, respectively, will be subject to future notice and comment rule-making.

Operating Statistics

The following table sets forth operating statistics for our operating segments for each of the periods presented. The operating statistics reflect data for the period of time we managed these operations:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>
Specialty hospitals data:⁽¹⁾				
Number of hospitals owned—start of period	116	114	118	115
Number of hospitals acquired	1	—	4	1
Number of hospital start-ups	1	2	2	2
Number of hospitals closed/sold	(3)	(2)	(9)	(4)
Number of hospitals owned—end of period	115	114	115	114
Number of hospitals managed—end of period	8	9	8	9
Total number of hospitals (all)—end of period	123	123	123	123
Long term acute care hospitals	104	101	104	101
Rehabilitation hospitals	19	22	19	22
Available licensed beds ⁽²⁾	5,208	5,189	5,208	5,189
Admissions ⁽²⁾	12,586	13,728	39,541	41,314
Patient days ⁽²⁾	296,202	316,170	951,292	950,419
Average length of stay (days) ⁽²⁾	24	23	24	23
Net revenue per patient day ⁽²⁾⁽³⁾	\$1,642	\$1,676	\$1,651	\$1,707
Occupancy rate ⁽²⁾	62%	66%	67%	67%
Percent patient days—Medicare ⁽²⁾	53%	53%	55%	54%
Outpatient rehabilitation data:				
Number of clinics owned—start of period	1,435	1,441	896	1,445
Number of clinics acquired	3	4	546	5
Number of clinic start-ups	7	3	20	17
Number of clinics closed/sold	(8)	(13)	(25)	(32)
Number of clinics owned—end of period	1,437	1,435	1,437	1,435
Number of clinics managed—end of period	166	169	166	169
Total number of clinics (all)—end of period	1,603	1,604	1,603	1,604
Number of visits ⁽²⁾	2,052,678	1,986,213	5,751,562	6,168,763
Net revenue per visit ⁽²⁾⁽⁴⁾	\$102	\$104	\$102	\$103
Concentra data:				
Number of centers owned—start of period	301	315	300	300
Number of centers acquired	1	—	3	11
Number of center start-ups	—	—	—	4
Number of centers closed/sold	(1)	(3)	(2)	(3)
Number of centers owned—end of period	301	312	301	312
Number of visits ⁽⁵⁾	1,906,242	1,979,481	5,642,305	5,848,551
Net revenue per visit ⁽⁵⁾⁽⁶⁾	\$119	\$116	\$118	\$117

(1) Specialty hospitals consist of LTCHs and IRFs.

(2) Data excludes specialty hospitals and outpatient clinics managed by the Company.

(3) Net revenue per patient day is calculated by dividing specialty hospitals direct patient service revenues by the total number of patient days.

(4) Net revenue per visit is calculated by dividing outpatient rehabilitation clinic direct patient service revenue by the total number of visits. For purposes of this computation, outpatient rehabilitation direct patient service clinic revenue does not include managed clinics or contract therapy revenue.

(5) Data excludes onsite clinics and CBOCs.

(6) Net revenue per visit is calculated by dividing center direct patient service revenue by the total number of center visits.

Results of Operations

The following table outlines selected operating data as a percentage of net operating revenues for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2017	2016	2017
Net operating revenues	100.0%	100.0%	100.0%	100.0%
Cost of services ⁽¹⁾	86.9	85.6	85.0	83.7
General and administrative	2.6	2.5	2.5	2.5
Bad debt expense	1.7	1.9	1.6	1.8
Depreciation and amortization	3.5	3.4	3.4	3.6
Income from operations	5.3	6.6	7.5	8.4
Loss on early retirement of debt	(1.0)	—	(0.4)	(0.6)
Equity in earnings of unconsolidated subsidiaries	0.5	0.3	0.5	0.5
Non-operating gain (loss)	(0.1)	—	1.1	(0.0)
Interest expense	(4.2)	(3.4)	(3.9)	(3.5)
Income before income taxes	0.5	3.5	4.8	4.8
Income tax expense	0.1	1.2	1.6	1.8
Net income	0.4	2.3	3.2	3.0
Net income (loss) attributable to non-controlling interests	(0.2)	0.6	0.3	0.7
Net income attributable to Holdings and Select	0.6%	1.7%	2.9%	2.3%

(1) Cost of services includes salaries, wages and benefits, operating supplies, lease and rent expense and other operating costs.

The following table summarizes selected financial data by business segment for the periods indicated:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2017	% Change	2016	2017	% Change
	(in thousands)					
Net operating revenues:						
Specialty hospitals	\$ 544,491	\$ 585,288	7.5%	\$ 1,729,261	\$ 1,785,035	3.2%
Outpatient rehabilitation ⁽¹⁾	250,710	250,527	(0.1)	745,720	764,450	2.5
Concentra	258,507	261,295	1.1	764,252	779,030	1.9
Other ⁽²⁾	87	56	N/M	523	687	N/M
Total Company	<u>\$1,053,795</u>	<u>\$1,097,166</u>	<u>4.1%</u>	<u>\$ 3,239,756</u>	<u>\$ 3,329,202</u>	<u>2.8%</u>
Income (loss) from operations:						
Specialty hospitals	\$ 33,947	\$ 54,017	59.1%	\$ 175,737	\$ 206,900	17.7%
Outpatient rehabilitation ⁽¹⁾	25,836	23,334	(9.7)	82,609	84,393	2.2
Concentra	25,417	24,777	(2.5)	71,933	78,308	8.9
Other ⁽²⁾	(29,038)	(30,030)	(3.4)	(86,177)	(90,075)	(4.5)
Total Company	<u>\$ 56,162</u>	<u>\$ 72,098</u>	<u>28.4%</u>	<u>\$ 244,102</u>	<u>\$ 279,526</u>	<u>14.5%</u>
Adjusted EBITDA:						
Specialty hospitals	\$ 48,264	\$ 69,454	43.9%	\$ 217,759	\$ 256,291	17.7%
Outpatient rehabilitation ⁽¹⁾	31,995	29,298	(8.4)	99,006	102,575	3.6
Concentra	40,888	40,003	(2.2)	118,080	125,656	6.4
Other ⁽²⁾	(23,070)	(22,928)	0.6	(66,696)	(71,125)	(6.6)
Total Company	<u>\$ 98,077</u>	<u>\$ 115,827</u>	<u>18.1%</u>	<u>\$ 368,149</u>	<u>\$ 413,397</u>	<u>12.3%</u>
Adjusted EBITDA margins:						
Specialty hospitals	8.9%	11.9%		12.6%	14.4%	
Outpatient rehabilitation ⁽¹⁾	12.8	11.7		13.3	13.4	
Concentra	15.8	15.3		15.5	16.1	
Other ⁽²⁾	N/M	N/M		N/M	N/M	
Total Company	<u>9.3%</u>	<u>10.6%</u>		<u>11.4%</u>	<u>12.4%</u>	
Total assets: ⁽³⁾						
Specialty hospitals	\$2,469,060	\$2,748,761		\$2,469,060	\$2,748,761	
Outpatient rehabilitation	955,359	945,765		955,359	945,765	
Concentra	1,318,866	1,332,012		1,318,866	1,332,012	
Other ⁽²⁾	73,992	97,269		73,992	97,269	
Total Company	<u>\$4,817,277</u>	<u>\$5,123,807</u>		<u>\$4,817,277</u>	<u>\$5,123,807</u>	
Purchases of property and equipment, net:						
Specialty hospitals	\$ 24,378	\$ 37,376		\$ 79,366	\$ 106,424	
Outpatient rehabilitation ⁽¹⁾	6,234	6,496		15,032	19,370	
Concentra	2,720	5,369		10,647	21,656	
Other ⁽²⁾	4,670	19,257		13,215	26,350	
Total Company	<u>\$ 38,002</u>	<u>\$ 68,498</u>		<u>\$ 118,260</u>	<u>\$ 173,800</u>	

N/M—Not Meaningful.

- (1) The outpatient rehabilitation segment includes the operating results of our contract therapy businesses through March 31, 2016 and Physiotherapy beginning March 4, 2016.
- (2) Other includes our corporate services and certain other non-consolidating joint ventures and minority investments in other healthcare related businesses.
- (3) Reflects the retrospective adoption of ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*. Total assets as of September 30, 2016 were retrospectively conformed to reflect the adoption of the standard, resulting in a reduction to total assets of \$28.1 million.

Three Months Ended September 30, 2017 Compared to Three Months Ended September 30, 2016

In the following, we discuss our results of operations related to net operating revenues, operating expenses, Adjusted EBITDA, depreciation and amortization, income from operations, loss on early retirement of debt, equity in earnings of unconsolidated subsidiaries, interest expense, income taxes, and net income (loss) attributable to non-controlling interests, which, in each case, are the same for Holdings and Select.

Net Operating Revenues

Our net operating revenues increased 4.1% to \$1,097.2 million for the three months ended September 30, 2017, compared to \$1,053.8 million for the three months ended September 30, 2016.

Specialty Hospitals Segment. Net operating revenues increased 7.5% to \$585.3 million for the three months ended September 30, 2017, compared to \$544.5 million for the three months ended September 30, 2016 for our specialty hospitals segment. The increase in net operating revenues is principally due to several new inpatient rehabilitation facilities which commenced operations during 2016 and 2017 and an increase in patient volumes at our LTCHs. Our patient days increased 6.7% to 316,170 days for the three months ended September 30, 2017, compared to 296,202 days for the three months ended September 30, 2016. The average net revenue per patient day for our specialty hospitals increased 2.1% to \$1,676 for the three months ended September 30, 2017, compared to \$1,642 for the three months ended September 30, 2016.

Outpatient Rehabilitation Segment. Net operating revenues were \$250.5 million for the three months ended September 30, 2017, compared to \$250.7 million for the three months ended September 30, 2016 for our outpatient rehabilitation segment. The decrease in net operating revenues was principally due to a decline in visits within areas affected by Hurricanes Harvey and Irma, which caused an estimated \$2.9 million decrease in net operating revenues. Additionally, we experienced a decline in visits at Physiotherapy clinics within some of our markets. We had 1,986,213 visits in our clinics for the three months ended September 30, 2017, compared to 2,052,678 visits for the three months ended September 30, 2016. The decline in net operating revenues attributable to lower patient volumes was offset in part by an increase in net revenue per visit. Net revenue per visit increased 2.0% to \$104 for the three months ended September 30, 2017, compared to \$102 for the three months ended September 30, 2016.

Concentra Segment. Net operating revenues increased 1.1% to \$261.3 million for the three months ended September 30, 2017, compared to \$258.5 million for the three months ended September 30, 2016 for our Concentra segment. The increase in net operating revenues was principally due to an increase in visits from newly acquired and developed medical centers, offset in part by a decline in visits within areas affected by Hurricanes Harvey and Irma, which caused an estimated \$1.2 million decrease in net operating revenues. Visits in our centers increased 3.8% to 1,979,481 visits for the three months ended September 30, 2017, compared to 1,906,242 visits for the three months ended September 30, 2016. The growth in visits primarily related to an increase in employer services visits. Net revenue per visit was \$116 for the three months ended September 30, 2017, compared to \$119 for the three months ended September 30, 2016. The decrease in net revenue per visit is principally due to an increased proportion of employer service visits, which yield lower per visit rates.

Operating Expenses

Our operating expenses include our cost of services, general and administrative expense, and bad debt expense. Our operating expenses were \$986.3 million, or 90.0% of net operating revenues, for the three months ended September 30, 2017, compared to \$960.5 million, or 91.1% of net operating revenues, for the three months ended September 30, 2016. Our cost of services, a major component of which is labor expense, was \$938.9 million, or 85.6% of net operating revenues, for the three months ended September 30, 2017, compared to \$915.7 million, or 86.9% of net operating revenues, for the three months ended September 30, 2016. The decrease in our operating expenses relative to our net operating revenues is principally due to the improved operating performance of our acquired and start-up specialty hospitals. Facility rent expense, a component of cost of services, was \$57.9 million for the three months ended September 30, 2017, compared to \$58.5 million for the three months ended September 30, 2016. General and administrative expenses were \$27.1 million for both the three months ended September 30, 2017 and 2016. General and administrative expenses as a percentage of net operating revenues were 2.5% for the three months ended September 30, 2017, compared to 2.6% for the three months ended September 30, 2016. Our bad debt expense was \$20.3 million, or 1.9% of net operating revenues, for the three months ended September 30, 2017, compared to \$17.7 million, or 1.7% of net operating revenues, for the three months ended September 30, 2016. The increase in bad debt expense occurred principally in our specialty hospitals segment.

Adjusted EBITDA

Specialty Hospitals Segment. Adjusted EBITDA increased 43.9% to \$69.5 million for the three months ended September 30, 2017, compared to \$48.3 million for the three months ended September 30, 2016 for our specialty hospitals segment. Our Adjusted EBITDA margin for the specialty hospitals segment was 11.9% for the three months ended September 30, 2017, compared to 8.9% for the three months ended September 30, 2016. The increases in Adjusted EBITDA and Adjusted EBITDA margin for our specialty hospitals segment were primarily driven by the improved operating performance of our LTCHs and reductions in Adjusted EBITDA losses in our start-up specialty hospitals. Adjusted EBITDA losses in our start-up specialty hospitals were \$1.5 million for the three months ended September 30, 2017, compared to \$9.0 million for the three months ended September 30, 2016.

Outpatient Rehabilitation Segment. Adjusted EBITDA was \$29.3 million for the three months ended September 30, 2017, compared to \$32.0 million for the three months ended September 30, 2016 for our outpatient rehabilitation segment. Our Adjusted EBITDA margin for the outpatient rehabilitation segment was 11.7% for the three months ended September 30, 2017, compared to 12.8% for the three months ended September 30, 2016. The decrease in Adjusted EBITDA was principally due to a decline in visits within areas affected by Hurricanes Harvey and Irma, as discussed above under “*Net Operating Revenues*.” Additionally, we experienced a decline in visits at Physiotherapy clinics within some of our markets. The decline in our Adjusted EBITDA margin for our outpatient rehabilitation segment was the result of higher labor expenses relative to our net operating revenues within markets which have experienced a decline in patient volumes.

Concentra Segment. Adjusted EBITDA was \$40.0 million for the three months ended September 30, 2017, compared to \$40.9 million for the three months ended September 30, 2016 for our Concentra segment. Our Adjusted EBITDA margin for the Concentra segment was 15.3% for the three months ended September 30, 2017, compared to 15.8% for the three months ended September 30, 2016. The decrease in Adjusted EBITDA was principally due to a decline in visits within areas affected by Hurricanes Harvey and Irma, as discussed above under “*Net Operating Revenues*.”

Other. The Adjusted EBITDA loss was \$22.9 million for the three months ended September 30, 2017, compared to an Adjusted EBITDA loss of \$23.1 million for the three months ended September 30, 2016.

Depreciation and Amortization

Depreciation and amortization expense was \$38.8 million for the three months ended September 30, 2017, compared to \$37.2 million for the three months ended September 30, 2016. The increase was principally due to new inpatient rehabilitation facilities operating in our specialty hospitals segment.

Income from Operations

For the three months ended September 30, 2017, we had income from operations of \$72.1 million, compared to \$56.2 million for the three months ended September 30, 2016. The increase in income from operations resulted principally from the improved operating performance of our specialty hospitals segment.

Loss on Early Retirement of Debt

On September 26, 2016, Concentra prepaid the second lien term loan under the Concentra credit facilities, resulting in a loss on early retirement of debt of approximately \$10.9 million. The loss on early retirement of debt consisted of a prepayment premium, unamortized debt issuance costs, and unamortized original issue discounts.

Equity in Earnings of Unconsolidated Subsidiaries

For the three months ended September 30, 2017, we had equity in earnings of unconsolidated subsidiaries of \$4.4 million, compared to \$5.3 million for the three months ended September 30, 2016. The decrease in our equity in earnings of unconsolidated subsidiaries resulted principally from losses incurred by start-up companies in which we own a minority interest.

Interest Expense

Interest expense was \$37.7 million for the three months ended September 30, 2017, compared to \$44.5 million for the three months ended September 30, 2016. The decrease in interest expense was principally the result of decreases in our interest rates associated with the refinancing of the Select credit facilities during the quarter ended March 31, 2017 and the Concentra credit facilities during the quarter ended September 30, 2016.

Income Taxes

We recorded income tax expense of \$14.0 million for the three months ended September 30, 2017, which represented an effective tax rate of 36.1%. We recorded income tax expense of \$1.1 million for the three months ended September 30, 2016, which represented an effective tax rate of 21.2%. Our quarterly effective income tax rate is derived from our full year estimated effective income tax rate and can be impacted by discrete items specific to a particular quarter and quarterly changes in our full year tax provision estimate.

Net Income (Loss) Attributable to Non-Controlling Interests

Net income attributable to non-controlling interests was \$6.4 million for the three months ended September 30, 2017, compared to net losses attributable to non-controlling interests of \$2.5 million for the three months ended September 30, 2016. The increase is principally due to increases in net income of our joint venture subsidiary, Concentra, and the improved operating performance of joint venture inpatient rehabilitation facilities operating within our specialty hospitals segment.

Nine Months Ended September 30, 2017 Compared to Nine Months Ended September 30, 2016

In the following, we discuss our results of operations related to net operating revenues, operating expenses, Adjusted EBITDA, depreciation and amortization, income from operations, loss on early retirement of debt, equity in earnings of unconsolidated subsidiaries, non-operating gain, interest expense, income taxes, and net income attributable to non-controlling interests, which, in each case, are the same for Holdings and Select.

Net Operating Revenues

Our net operating revenues increased 2.8% to \$3,329.2 million for the nine months ended September 30, 2017, compared to \$3,239.8 million for the nine months ended September 30, 2016.

Specialty Hospitals Segment. Net operating revenues increased 3.2% to \$1,785.0 million for the nine months ended September 30, 2017, compared to \$1,729.3 million for the nine months ended September 30, 2016 for our specialty hospitals segment. The increase in net operating revenues is principally due to several new inpatient rehabilitation facilities which commenced operations during 2016 and 2017. The average net revenue per patient day for our specialty hospitals increased 3.4% to \$1,707 for the nine months ended September 30, 2017, compared to \$1,651 for the nine months ended September 30, 2016. For the nine months ended September 30, 2017, we had 950,419 patient days, compared to 951,292 days for the nine months ended September 30, 2016. The decrease in patient days is principally due to closed specialty hospitals.

Outpatient Rehabilitation Segment. Net operating revenues increased 2.5% to \$764.5 million for the nine months ended September 30, 2017, compared to \$745.7 million for the nine months ended September 30, 2016 for our outpatient rehabilitation segment. The increase in net operating revenues was principally due to the acquisition of Physiotherapy on March 4, 2016, which contributed to the overall growth in our visits. Additionally, we experienced an increase in our net revenue per visit. Visits increased 7.3% to 6,168,763 for the nine months ended September 30, 2017, compared to 5,751,562 visits for the nine months ended September 30, 2016. Net revenue per visit increased 1.0% to \$103 for the nine months ended September 30, 2017, compared to \$102 for the nine months ended September 30, 2016. The increase in net operating revenues was offset in part by the sale of our contract therapy businesses on March 31, 2016.

Concentra Segment. Net operating revenues increased 1.9% to \$779.0 million for the nine months ended September 30, 2017, compared to \$764.3 million for the nine months ended September 30, 2016 for our Concentra segment. The increase in net operating revenues was principally due to an increase in visits from newly acquired and developed medical centers. Visits in our centers increased 3.7% to 5,848,551 for the nine months ended September 30, 2017, compared to 5,642,305 visits for the nine months ended September 30, 2016. The growth in visits principally related to an increase in employer services visits. Net revenue per visit was \$117 for the nine months ended September 30, 2017, compared to \$118 for the nine months ended September 30, 2016. The decrease in net revenue per visit is principally due to an increased proportion of employer service visits, which yield lower per visit rates.

Operating Expenses

Our operating expenses include our cost of services, general and administrative expense, and bad debt expense. Our operating expenses were \$2,930.0 million, or 88.0% of net operating revenues, for the nine months ended September 30, 2017, compared to \$2,887.8 million, or 89.1% of net operating revenues, for the nine months ended September 30, 2016. Our cost of services, a major component of which is labor expense, was \$2,787.5 million, or 83.7% of net operating revenues, for the nine months ended September 30, 2017, compared to \$2,755.0 million, or 85.0% of net operating revenues, for the nine months ended September 30, 2016. The decrease in our operating expenses relative to our net operating revenues is principally due to the improved operating performance of our acquired and start-up specialty hospitals, specialty hospitals closures, and cost reductions achieved by Concentra. Facility rent expense, a component of cost of services, was \$171.7 million for the nine months ended September 30, 2017, compared to \$167.5 million for the nine months ended September 30, 2016. General and administrative expenses were \$83.4 million for the nine months ended September 30, 2017, compared to \$81.2 million for the nine months ended September 30, 2016, which included \$3.2 million of Physiotherapy acquisition costs. General and administrative expenses as a percentage of net operating revenues were 2.5% for both the nine months ended September 30, 2017 and 2016. Our bad debt expense was \$59.1 million, or 1.8% of net operating revenues, for the nine months ended September 30, 2017, compared to \$51.6 million, or 1.6% of net operating revenues, for the nine months ended September 30, 2016. The increase was principally the result of increases in bad debt expense in our specialty hospitals and Concentra segments.

Adjusted EBITDA

Specialty Hospitals Segment. Adjusted EBITDA increased 17.7% to \$256.3 million for the nine months ended September 30, 2017, compared to \$217.8 million for the nine months ended September 30, 2016 for our specialty hospitals segment. Our Adjusted EBITDA margin for the segment was 14.4% for the nine months ended September 30, 2017, compared to 12.6% for the nine months ended September 30, 2016. The increases in Adjusted EBITDA and Adjusted EBITDA margin for our specialty hospitals segment were primarily driven by the improved operating performance of our LTCHs, reductions in Adjusted EBITDA losses in our start-up specialty hospitals, and the closure of specialty hospitals which had generated Adjusted EBITDA losses during the nine months ended September 30, 2016. Adjusted EBITDA losses in our start-up specialty hospitals were \$4.7 million for the nine months ended September 30, 2017, compared to \$19.4 million for the nine months ended September 30, 2016.

Outpatient Rehabilitation Segment. Adjusted EBITDA increased 3.6% to \$102.6 million for the nine months ended September 30, 2017, compared to \$99.0 million for the nine months ended September 30, 2016 for our outpatient rehabilitation segment. The increase in Adjusted EBITDA was principally due to growth in visits and an increase in net revenue per visit, as discussed above under “*Net Operating Revenues*.” Our Adjusted EBITDA margin for the outpatient rehabilitation segment was 13.4% for the nine months ended September 30, 2017, compared to 13.3% for the nine months ended September 30, 2016. The increase in Adjusted EBITDA margin was principally due to the sale of our contract therapy businesses on March 31, 2016, which operated at lower Adjusted EBITDA margins than our outpatient rehabilitation clinics.

Concentra Segment. Adjusted EBITDA increased 6.4% to \$125.7 million for the nine months ended September 30, 2017, compared to \$118.1 million for the nine months ended September 30, 2016 for our Concentra segment. Our Adjusted EBITDA margin for the Concentra segment was 16.1% for the nine months ended September 30, 2017, compared to 15.5% for the nine months ended September 30, 2016. The increases in Adjusted EBITDA and Adjusted EBITDA margins for our Concentra segment were principally the result of cost reductions we have achieved.

Other. The Adjusted EBITDA loss was \$71.1 million for the nine months ended September 30, 2017, compared to an Adjusted EBITDA loss of \$66.7 million for the nine months ended September 30, 2016. The increase in our Adjusted EBITDA loss was due to an increase in general and administrative costs, which encompass our corporate shared service activities.

Depreciation and Amortization

Depreciation and amortization expense was \$119.6 million for the nine months ended September 30, 2017, compared to \$107.9 million for the nine months ended September 30, 2016. The increase was principally due to new inpatient rehabilitation facilities operating in our specialty hospitals segment.

Income from Operations

For the nine months ended September 30, 2017, we had income from operations of \$279.5 million, compared to \$244.1 million for the nine months ended September 30, 2016. The increase in income from operations resulted principally from the improved operating performance of our specialty hospitals and Concentra segments.

Loss on Early Retirement of Debt

On March 6, 2017, we refinanced Select’s senior secured credit facilities which resulted in losses on early retirement of debt of \$19.7 million during the nine months ended September 30, 2017.

On March 4, 2016, we refinanced a portion of our term loans under Select’s 2011 senior secured credit facility which resulted in a loss on early retirement of debt of \$0.8 million. On September 26, 2016, Concentra prepaid the second lien term loan under the Concentra credit facilities, resulting in a loss on early retirement of debt of approximately \$10.9 million.

Equity in Earnings of Unconsolidated Subsidiaries

For the nine months ended September 30, 2017, we had equity in earnings of unconsolidated subsidiaries of \$15.6 million, compared to \$14.5 million for the nine months ended September 30, 2016. The increase in our equity in earnings of unconsolidated subsidiaries resulted principally from improved performance of the inpatient rehabilitation businesses in which we have a minority interest.

Non-Operating Gain

We recognized a non-operating gain of \$37.1 million during the nine months ended September 30, 2016. The non-operating gain was principally due to the sale of our contract therapy businesses on March 31, 2016, as well as the sale of nine outpatient rehabilitation clinics to a non-consolidating subsidiary and the sale of five specialty hospitals in an exchange transaction during the quarter ended June 30, 2016.

Interest Expense

Interest expense was \$116.2 million for the nine months ended September 30, 2017, compared to \$127.7 million for the nine months ended September 30, 2016. The decrease in interest expense was principally the result of decreases in our interest rates associated with the refinancing of the Select credit facilities during the quarter ended March 31, 2017 and the Concentra credit facilities during the quarter ended September 30, 2016.

Income Taxes

We recorded income tax expense of \$59.6 million for the nine months ended September 30, 2017, which represented an effective tax rate of 37.4%. We recorded income tax expense of \$51.6 million for the nine months ended September 30, 2016, which represented an effective tax rate of 33.0%.

Our effective income tax rate is derived from our full year estimated effective income tax rate and can be impacted by discrete items specific to a particular quarter and quarterly changes in our full year tax provision estimate. On March 31, 2016, we sold our contract therapy businesses. Our tax basis in our contract therapy businesses exceeded our selling price; as a result, we had no tax expense from the sale. During the quarter ended June 30, 2016, we exchanged five specialty hospitals. Our tax basis in the five specialty hospitals was less than our book basis, resulting in a tax gain exceeding our book gain. The lower effective tax rate for the nine months ended September 30, 2016 resulted from the net effects of the two discrete tax events discussed above.

Net Income Attributable to Non-Controlling Interests

Net income attributable to non-controlling interests was \$23.2 million for the nine months ended September 30, 2017, compared to \$9.6 million for the nine months ended September 30, 2016. The increase is principally due to increases in net income of our joint venture subsidiary, Concentra, and the improved operating performance of joint venture inpatient rehabilitation facilities operating within our specialty hospitals segment.

Liquidity and Capital Resources

Cash Flows for the Nine Months Ended September 30, 2017 and Nine Months Ended September 30, 2016

In the following, we discuss cash flows from operating activities, investing activities, and financing activities, which, in each case, are the same for Holdings and Select.

	Nine Months Ended September 30,	
	2016	2017
	(in thousands)	
Cash flows provided by operating activities	\$ 280,761	\$ 129,972
Cash flows used in investing activities	(463,002)	(169,990)
Cash flows provided by financing activities	<u>236,029</u>	<u>48,289</u>
Net increase in cash and cash equivalents	53,788	8,271
Cash and cash equivalents at beginning of period	14,435	99,029
Cash and cash equivalents at end of period	<u>\$ 68,223</u>	<u>\$ 107,300</u>

Operating activities provided \$130.0 million of cash flows for the nine months ended September 30, 2017. The decrease in operating cash flows for the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016 is principally due to increases in our accounts receivable. Our days sales outstanding was 60 days at September 30, 2017, compared to 51 days at December 31, 2016 and 52 days at September 30, 2016. Our days sales outstanding will fluctuate based upon variability in our collection cycles. The increase in our days sales outstanding and related decline in our operating cash flows is primarily related to the current underpayments we are receiving through the periodic interim payment program from Medicare in our LTCHs. These underpayments will be corrected in future months as our periodic interim payments are reconciled and reset by our fiscal intermediaries.

Investing activities used \$170.0 million for the nine months ended September 30, 2017. The principal use of cash was \$173.8 million for purchases of property and equipment and \$19.4 million for the acquisition of businesses, offset in part by \$34.6 million of proceeds received from the sale of assets. Investing activities used \$463.0 million of cash flows for the nine months ended September 30, 2016, principally due to the acquisition of Physiotherapy. Investing activities for the nine months ended September 30, 2016 also included \$118.3 million for purchases of property and equipment, offset in part by proceeds received from the sales of businesses and an equity investment of \$72.6 million.

Financing activities provided \$48.3 million of cash flows for the nine months ended September 30, 2017. The principal source of cash was \$100.0 million of net borrowings under the Select revolving facility, offset in part by \$23.1 million of cash used for a principal prepayment associated with the Concentra credit facilities, \$5.8 million of cash used for term loan payments associated with the Select credit facilities, and cash used for the payment of financing costs related to the refinancing of the Select credit facilities.

Financing activities provided \$236.0 million of cash flows for the nine months ended September 30, 2016. The principal source of cash was the issuance of \$625.0 million of series F tranche B term loans, resulting in net proceeds of \$600.1 million, offset in part by \$215.7 million of cash used to repay the series D tranche B term loans and \$125.0 million of net repayments under the Select and Concentra revolving facilities.

Capital Resources

Working capital. We had net working capital of \$304.5 million at September 30, 2017, compared to \$191.3 million at December 31, 2016. The increase in net working capital is primarily due to an increase in our accounts receivable.

Select credit facilities. On March 6, 2017, Select entered into a new senior secured credit agreement that provides for \$1.6 billion in senior secured credit facilities comprising a \$1.15 billion, seven-year term loan and a \$450.0 million, five-year revolving credit facility, including a \$75.0 million sublimit for the issuance of standby letters of credit. Select used borrowings under the Select credit facilities to: (i) repay the series E tranche B term loans due June 1, 2018, the series F tranche B term loans due March 31, 2021, and the revolving facility maturing March 1, 2018 under its then existing credit facilities; and (ii) pay fees and expenses in connection with the refinancing.

Borrowings under the Select credit facilities bear interest at a rate equal to: (i) in the case of the Select term loan, Adjusted LIBO (as defined in the Select credit agreement) plus 3.50% (subject to an Adjusted LIBO floor of 1.00%), or Alternate Base Rate (as defined in the Select credit agreement) plus 2.50% (subject to an Alternate Base Rate floor of 2.00%); and (ii) in the case of the Select revolving facility, Adjusted LIBO plus a percentage ranging from 3.00% to 3.25% or Alternate Base Rate plus a percentage ranging from 2.00% to 2.25%, in each case based on Select's leverage ratio.

The Select term loan amortizes in equal quarterly installments in amounts equal to 0.25% of the aggregate original principal amount of the Select term loan commencing on June 30, 2017. The balance of the Select term loan will be payable on March 8, 2024; however, if the Select 6.375% senior notes, which are due June 1, 2021, are outstanding on March 1, 2021, the maturity date for the Select term loan will become March 1, 2021. The Select revolving facility will be payable on March 8, 2022; however, if the Select 6.375% senior notes are outstanding on February 1, 2021, the maturity date for the Select revolving facility will become February 1, 2021.

Select will be required to prepay borrowings under the Select credit facilities with (i) 100% of the net cash proceeds received from non-ordinary course asset sales or other dispositions, or as a result of a casualty or condemnation, subject to reinvestment provisions and other customary carveouts and, to the extent required, the payment of certain indebtedness secured by liens having priority over the debt under the Select credit facilities or subject to a first lien intercreditor agreement, (ii) 100% of the net cash proceeds received from the issuance of debt obligations other than certain permitted debt obligations, and (iii) 50% of excess cash flow (as defined in the Select credit agreement) if Select's leverage ratio is greater than 4.50 to 1.00 and 25% of excess cash flow if Select's leverage ratio is less than or equal to 4.50 to 1.00 and greater than 4.00 to 1.00, in each case, reduced by the aggregate amount of term loans, revolving loans and certain other debt optionally prepaid during the applicable fiscal year. Select will not be required to prepay borrowings with excess cash flow if Select's leverage ratio is less than or equal to 4.00 to 1.00.

The Select revolving facility requires Select to maintain a leverage ratio (as defined in the Select credit agreement), which is tested quarterly, not to exceed 6.25 to 1.00. After March 31, 2019, the leverage ratio must not exceed 6.00 to 1.00. Failure to comply with this covenant would result in an event of default under the Select revolving facility and, absent a waiver or an amendment from the revolving lenders, preclude Select from making further borrowings under the Select revolving facility and permit the revolving lenders to accelerate all outstanding borrowings under the Select revolving facility. The termination of the Select revolving facility commitments and the acceleration of amounts outstanding thereunder would constitute an event of default with respect to the Select term loan. As of September 30, 2017, Select's leverage ratio was 5.82 to 1.00.

The Select credit facilities also contain a number of other affirmative and restrictive covenants, including limitations on mergers, consolidations and dissolutions; sales of assets; investments and acquisitions; indebtedness; liens; affiliate transactions; and dividends and restricted payments. The Select credit facilities contain events of default for non-payment of principal and interest when due (subject, as to interest, to a grace period), cross-default and cross-acceleration provisions and an event of default that would be triggered by a change of control.

Borrowings under the Select credit facilities are guaranteed by Holdings and substantially all of Select's current domestic subsidiaries and will be guaranteed by substantially all of Select's future domestic subsidiaries and secured by substantially all of Select's existing and future property and assets and by a pledge of Select's capital stock, the capital stock of Select's domestic subsidiaries and up to 65% of the capital stock of Select's foreign subsidiaries held directly by Select or a domestic subsidiary.

At September 30, 2017, Select had outstanding borrowings under the Select credit facilities consisting of a \$1,144.3 million Select term loan (excluding unamortized discounts and debt issuance costs of \$26.0 million) and borrowings of \$320.0 million (excluding letters of credit) under the Select revolving facility. At September 30, 2017, Select had \$91.4 million of availability under the Select revolving facility after giving effect to \$38.6 million of outstanding letters of credit.

Concentra credit facilities. Select and Holdings are not parties to the Concentra credit facilities and are not obligors with respect to Concentra's debt under such agreements. While this debt is non-recourse to Select, it is included in Select's consolidated financial statements.

On March 1, 2017, Concentra made a principal prepayment of \$23.1 million associated with its first lien term loans in accordance with the provision in the Concentra credit facilities that requires mandatory prepayments of term loans as a result of annual excess cash flow, as defined in the Concentra credit facilities.

As of September 30, 2017, Concentra had \$619.2 million of first lien term loans outstanding (excluding unamortized discounts and debt issuance costs of \$13.7 million) under the Concentra credit facilities. Concentra did not have any borrowings, excluding letters of credit, outstanding under the Concentra revolving facility. At September 30 2017, Concentra had \$43.4 million of availability under its revolving facility after giving effect to \$6.6 million of outstanding letters of credit.

Stock Repurchase Program. Holdings' board of directors has authorized a common stock repurchase program to repurchase up to \$500.0 million worth of shares of its common stock. The program has been extended until December 31, 2018, and will remain in effect until then, unless further extended or earlier terminated by the board of directors. Stock repurchases under this program may be made in the open market or through privately negotiated transactions, and at times and in such amounts as Holdings deems appropriate. Holdings funds this program with cash on hand and borrowings under the Select revolving facility. Holdings did not repurchase shares during the three months ended September 30, 2017. Since the inception of the program through September 30, 2017, Holdings has repurchased 35,924,128 shares at a cost of approximately \$314.7 million, or \$8.76 per share, which includes transaction costs.

Liquidity. We believe our internally generated cash flows and borrowing capacity under the Select and Concentra credit facilities will be sufficient to finance operations over the next twelve months. We may from time to time seek to retire or purchase our outstanding debt through cash purchases and/or exchanges for equity securities, in open market purchases, privately negotiated transactions, tender offers or otherwise. Such repurchases or exchanges, if any, may be funded from operating cash flows or other sources and will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

Use of Capital Resources. We may from time to time pursue opportunities to develop new joint venture relationships with significant health systems and other healthcare providers, and from time to time we may also develop new inpatient rehabilitation hospitals and occupational medicine centers. We also intend to open new outpatient rehabilitation clinics in local areas that we currently serve where we can benefit from existing referral relationships and brand awareness to produce incremental growth. In addition to our development activities, we may grow through opportunistic acquisitions such as the pending acquisition of U.S. HealthWorks.

Recent Accounting Pronouncements

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805), Clarifying the Definition of a Business*, which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. ASU 2017-01 states that if substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the transaction should be accounted for as an asset acquisition. In addition, the ASU clarifies the requirements for a set of activities to be considered a business and narrows the definition of an output. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill and consolidation. ASU 2017-01 will be applied prospectively and is effective for annual periods beginning after December 15, 2017. Early adoption is permitted.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740), Intra-Entity Transfers of Assets Other Than Inventory*. Current GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. The ASU requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The standard will be effective for fiscal years beginning after December 15, 2017. The Company plans to adopt the guidance effective January 1, 2018. Adoption of the guidance will be applied on a modified retrospective approach through a cumulative effect adjustment to retained earnings as of the effective date. The Company is currently evaluating the standard to determine the impact it will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU includes a lessee accounting model that recognizes two types of leases; finance and operating. This ASU requires that a lessee recognize on the balance sheet assets and liabilities for all leases with lease terms of more than twelve months. Lessees will need to recognize almost all leases on the balance sheet as a right-of-use asset and a lease liability. For income statement purposes, the FASB retained the dual model, requiring leases to be classified as either operating or finance. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or operating lease. For short-term leases of twelve months or less, lessees are permitted to make an accounting election by class of underlying asset not to recognize right-of-use assets or lease liabilities. If the alternative is elected, lease expense would be recognized generally on the straight-line basis over the respective lease term.

The amendments in ASU 2016-02 will take effect for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted as of the beginning of an interim or annual reporting period. A modified retrospective approach is required for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements.

Upon adoption, the Company will recognize significant assets and liabilities on the consolidated balance sheets as a result of the operating lease obligations of the Company. Operating lease expense will still be recognized as rent expense on a straight-line basis over the respective lease terms in the consolidated statements of operations.

The Company will implement the new standard beginning January 1, 2019. The Company's implementation efforts are focused on designing accounting processes, disclosure processes, and internal controls in order to account for its leases under the new standard.

In May 2014, March 2016, April 2016, and December 2016, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, ASU 2016-08, *Revenue from Contracts with Customers, Principal versus Agent Considerations*, ASU 2016-10, *Revenue from Contracts with Customers, Identifying Performance Obligations and Licensing*, ASU 2016-12, *Revenue from Contracts with Customers, Narrow Scope Improvements and Practical Expedients*, and ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customer* (collectively "the standards"), respectively, which supersede most of the current revenue recognition requirements. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. New disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers are also required. The standards require the selection of a retrospective or cumulative effect transition method.

The Company will implement the new standard beginning January 1, 2018 using the retrospective transition method. Adoption of the new standard will result in material changes to the presentation of net operating revenues and bad debt expense in the consolidated statements of operations, but the presentation of the amount of income from operations and net income is not expected to materially change upon adoption of the new standards. The principal change is how the new standard requires healthcare providers to estimate the amount of variable consideration to be included in the transaction price up to an amount which is probable that a significant reversal will not occur. The most common form of variable consideration the Company experiences are amounts for services provided that are ultimately not realizable from a customer. Under the current standards, the Company's estimate for unrealizable amounts was recorded to bad debt expense. Under the new standards, the Company's estimate for unrealizable amounts will be recognized as a constraint to revenue and will be reflected as an allowance. Substantially all of the bad debt expense as of September 30, 2016 and September 30, 2017 will be reclassified as an allowance when the Company retrospectively applies the guidance in the standards on January 1, 2018.

The Company's remaining implementation efforts are focused principally on refining the accounting processes, disclosure processes, and internal controls.

Recently Adopted Accounting Pronouncements

In November 2015, the FASB issued ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*, which changed the presentation of deferred income taxes. The standard changed the presentation of deferred income taxes through the requirement that all deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The Company adopted the standard on January 1, 2017. The consolidated balance sheet at December 31, 2016 has been retrospectively adjusted. Adoption of the new standard impacted the Company's previously reported results as follows:

	December 31, 2016	
	As Reported	As Adjusted
	(in thousands)	
Current deferred tax asset	\$ 45,165	\$ —
Total current assets	808,068	762,903
Other assets	152,548	173,944
Total assets	4,944,395	4,920,626
Non-current deferred tax liability	222,847	199,078
Total liabilities	3,616,335	3,592,566
Total liabilities and equity	4,944,395	4,920,626

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to interest rate risk in connection with our variable rate long-term indebtedness. Our principal interest rate exposure relates to the loans outstanding under the Select credit facilities and Concentra credit facilities.

As of September 30, 2017, Select had a \$1,144.3 million term loan outstanding (excluding unamortized discounts and debt issuance costs of \$26.0 million) and \$320.0 million in revolving borrowings outstanding under the Select credit facilities, which bear interest at variable rates.

As of September 30, 2017, Concentra had \$619.2 million of first lien term loans outstanding (excluding unamortized discounts and debt issuance costs of \$13.7 million) under the Concentra credit facilities, which bear interest at variable rates. Concentra did not have any outstanding revolving borrowings at September 30, 2017.

At September 30, 2017, the 3-month LIBOR rate was 1.33%. Consequently, each 0.25% increase in market interest rates will impact the interest expense on Select's and Concentra's variable rate debt by \$5.2 million per annum.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered in this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures, including the accumulation and communication of disclosure to our principal executive officer and principal financial officer as appropriate to allow timely decisions regarding disclosure, are effective as of September 30, 2017 to provide reasonable assurance that material information required to be included in our periodic SEC reports is recorded, processed, summarized, and reported within the time periods specified in the relevant SEC rules and forms.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934) identified in connection with the evaluation required by Rule 13a-15(d) of the Securities Exchange Act of 1934 that occurred during the third quarter ended September 30, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there is only reasonable assurance that our controls will succeed in achieving their goals under all potential future conditions.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is a party to various legal actions, proceedings, and claims (some of which are not insured), and regulatory and other governmental audits and investigations in the ordinary course of its business. The Company cannot predict the ultimate outcome of pending litigation, proceedings, and regulatory and other governmental audits and investigations. These matters could potentially subject the Company to sanctions, damages, recoupments, fines, and other penalties. The Department of Justice, CMS, or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company's businesses in the future that may, either individually or in the aggregate, have a material adverse effect on the Company's business, financial position, results of operations, and liquidity.

To address claims arising out of the Company's operations, the Company maintains professional malpractice liability insurance and general liability insurance, subject to self-insured retention of \$2.0 million per medical incident for professional liability claims and \$2.0 million per occurrence for general liability claims. The Company also maintains umbrella liability insurance covering claims which, due to their nature or amount, are not covered by or not fully covered by the Company's other insurance policies. These insurance policies also do not generally cover punitive damages and are subject to various deductibles and policy limits. Significant legal actions, as well as the cost and possible lack of available insurance, could subject the Company to substantial uninsured liabilities. In the Company's opinion, the outcome of these actions, individually or in the aggregate, will not have a material adverse effect on its financial position, results of operations or cash flows.

Healthcare providers are subject to lawsuits under the qui tam provisions of the federal False Claims Act. Qui tam lawsuits typically remain under seal (hence, usually unknown to the defendant) for some time while the government decides whether or not to intervene on behalf of a private qui tam plaintiff (known as a relator) and take the lead in the litigation. These lawsuits can involve significant monetary damages and penalties and award bounties to private plaintiffs who successfully bring the suits. The Company is and has been a defendant in these cases in the past, and may be named as a defendant in similar cases from time to time in the future.

Evansville Litigation

On October 19, 2015, the plaintiff-relators filed a Second Amended Complaint in United States of America, ex rel. Tracy Conroy, Pamela Schenk and Lisa Wilson v. Select Medical Corporation, Select Specialty Hospital—Evansville, LLC (“SSH-Evansville”), Select Employment Services, Inc., and Dr. Richard Sloan. The case is a civil action filed in the United States District Court for the Southern District of Indiana by private plaintiff-relators on behalf of the United States under the federal False Claims Act. The plaintiff-relators are the former CEO and two former case managers at SSH-Evansville, and the defendants currently include the Company, SSH-Evansville, a subsidiary of the Company serving as common paymaster for its employees, and a physician who practices at SSH-Evansville. The plaintiff-relators allege that SSH-Evansville discharged patients too early or held patients too long, improperly discharged patients to and readmitted them from short stay hospitals, up-coded diagnoses at admission, and admitted patients for whom long-term acute care was not medically necessary. They also allege that the defendants engaged in retaliation in violation of federal and state law. The Second Amended Complaint replaced a prior complaint that was filed under seal on September 28, 2012 and served on the Company on February 15, 2013, after a federal magistrate judge unsealed it on January 8, 2013. All deadlines in the case had been stayed after the seal was lifted in order to allow the government time to complete its investigation and to decide whether or not to intervene. On June 19, 2015, the United States Department of Justice notified the District Court of its decision not to intervene in the case.

In December 2015, the defendants filed a Motion to Dismiss the Second Amended Complaint on multiple grounds, including that the action is disallowed by the False Claims Act's public disclosure bar, which disqualifies qui tam actions that are based on fraud already publicly disclosed through enumerated sources, unless the relator is an original source, and that the plaintiff-relators did not plead their claims with sufficient particularity, as required by the Federal Rules of Civil Procedure.

Thereafter, the United States filed a notice asserting a veto of the defendants' use of the public disclosure bar for claims arising from conduct from and after March 23, 2010, which was based on certain statutory changes to the public disclosure bar language included in the Affordable Care Act. On September 30, 2016, the District Court partially granted and partially denied the defendants' Motion to Dismiss. It ruled that the plaintiff-relators alleged substantially the same conduct as had been publicly disclosed and that the plaintiff relators are not original sources, so that the public disclosure bar requires dismissal of all non-retaliation claims arising from conduct before March 23, 2010. The District Court also ruled that the statutory changes to the public disclosure bar gave the United States the power to veto its applicability to claims arising from conduct on and after March 23, 2010, and therefore did not dismiss those claims based on the public disclosure bar. However,

the District Court ruled that the plaintiff-relators did not plead certain of their claims relating to interrupted stay manipulation and premature discharging of patients with the requisite particularity, and dismissed those claims. The District Court declined to dismiss the plaintiff relators' claims arising from conduct from and after March 23, 2010 relating to delayed discharging of patients and up-coding and the plaintiff relators' retaliation claims. The plaintiff-relators then proposed a case management plan seeking nationwide discovery involving all of the Company's LTCHs for the period from March 23, 2010 through the present, which the defendants have opposed. The Company intends to vigorously defend this action, but at this time the Company is unable to predict the timing and outcome of this matter.

Knoxville Litigation

On July 13, 2015, the United States District Court for the Eastern District of Tennessee unsealed a qui tam Complaint in Armes v. Garman, et al, No. 3:14-cv-00172-TAV-CCS, which named as defendants Select, Select Specialty Hospital—Knoxville, Inc. ("SSH-Knoxville"), Select Specialty Hospital—North Knoxville, Inc. and ten current or former employees of these facilities. The Complaint was unsealed after the United States and the State of Tennessee notified the court on July 13, 2015 that each had decided not to intervene in the case. The Complaint is a civil action that was filed under seal on April 29, 2014 by a respiratory therapist formerly employed at SSH-Knoxville. The Complaint alleges violations of the federal False Claims Act and the Tennessee Medicaid False Claims Act based on extending patient stays to increase reimbursement and to increase average length of stay; artificially prolonging the lives of patients to increase Medicare reimbursements and decrease inspections; admitting patients who do not require medically necessary care; performing unnecessary procedures and services; and delaying performance of procedures to increase billing. The Complaint was served on some of the defendants during October 2015.

In November 2015, the defendants filed a Motion to Dismiss the Complaint on multiple grounds. The defendants first argued that False Claims Act's first-to-file bar required dismissal of plaintiff-relator's claims. Under the first-to-file bar, if a qui tam case is pending, no person may bring a related action based on the facts underlying the first action. The defendants asserted that the plaintiff-relator's claims were based on the same underlying facts as were asserted in the Evansville litigation, discussed above. The defendants also argued that the plaintiff-relator's claims must be dismissed under the public disclosure bar, and because the plaintiff-relator did not plead his claims with sufficient particularity.

In June 2016, the District Court granted the defendants' Motion to Dismiss and dismissed with prejudice the plaintiff-relator's lawsuit in its entirety. The District Court ruled that the first-to-file bar precludes all but one of the plaintiff-relator's claims, and that the remaining claim must also be dismissed because the plaintiff-relator failed to plead it with sufficient particularity. In July 2016, the plaintiff-relator filed a Notice of Appeal to the United States Court of Appeals for the Sixth Circuit. Then, on October 11, 2016, the plaintiff-relator filed a Motion to Remand the case to the District Court for further proceedings, arguing that the September 30, 2016 decision in the Evansville litigation, discussed above, undermines the basis for the District Court's dismissal. After the Court of Appeals denied the Motion to Remand, the plaintiff-relator then sought an indicative ruling from the District Court that it would vacate its prior dismissal ruling and allow plaintiff-relator to supplement his Complaint, which the defendants have opposed. The case has been fully briefed and argued in the Court of Appeals. The Company intends to vigorously defend this action, but at this time the Company is unable to predict the timing and outcome of this matter.

Wilmington Litigation

On January 19, 2017, the United States District Court for the District of Delaware unsealed a qui tam Complaint in United States of America and State of Delaware ex rel. Theresa Kelly v. Select Specialty Hospital—Wilmington, Inc. ("SSH-Wilmington"), Select Specialty Hospitals, Inc., Select Employment Services, Inc., Select Medical Corporation, and Crystal Cheek, No. 16-347-LPS. The Complaint was initially filed under seal on May 12, 2016 by a former chief nursing officer at SSH-Wilmington and was unsealed after the United States filed a Notice of Election to Decline Intervention on January 13, 2017. The corporate defendants were served on March 6, 2017. In the complaint, the plaintiff-relator alleges that the Select defendants and an individual defendant, who is a former health information manager at SSH-Wilmington, violated the False Claims Act and the Delaware False Claims and Reporting Act based on allegedly falsifying medical practitioner signatures on medical records and failing to properly examine the credentials of medical practitioners at SSH-Wilmington. In response to the Select defendants' motion to dismiss the Complaint, on May 17, 2017 the plaintiff-relator filed an Amended Complaint asserting the same causes of action. The Select defendants filed a Motion to Dismiss the Amended Complaint, which is now pending, based on numerous grounds, including that the Amended Complaint did not plead any alleged fraud with sufficient particularity, failed to plead that the alleged fraud was material to the government's payment decision, failed to plead sufficient facts to establish that the Select defendants knowingly submitted false claims or records, and failed to allege any reverse false claim.

On March 24, 2017, the plaintiff-relator initiated a second action by filing a Complaint in the Superior Court of the State of Delaware in Theresa Kelly v. Select Medical Corporation, Select Employment Services, Inc., and SSH-Wilmington, C.A. No. N17C-03-293 CLS. The Delaware Complaint alleges that the defendants retaliated against her in violation of the Delaware Whistleblowers' Protection Act for reporting the same alleged violations that are the subject of the federal Amended Complaint. The defendants filed a motion to dismiss, or alternatively to stay, the Delaware Complaint based on the pending federal Amended Complaint and the failure to allege facts to support a violation of the Delaware Whistleblowers' Protection Act. The motion is currently pending.

The Company intends to vigorously defend these actions, but at this time the Company is unable to predict the timing and outcome of this matter.

Contract Therapy Subpoena

On May 18, 2017, the Company received a subpoena from the U.S. Attorney's Office for the District of New Jersey seeking various documents principally relating to the Company's contract therapy division, which contracted to furnish rehabilitation therapy services to residents of skilled nursing facilities ("SNFs") and other providers. The Company operated its contract therapy division through a subsidiary until March 31, 2016, when the Company sold the stock of the subsidiary. The subpoena seeks documents that appear to be aimed at assessing whether therapy services were furnished and billed in compliance with Medicare SNF billing requirements, including whether therapy services were coded at inappropriate levels and whether excessive or unnecessary therapy was furnished to justify coding at higher paying levels. The Company does not know whether the subpoena has been issued in connection with a qui tam lawsuit or in connection with possible civil, criminal or administrative proceedings by the government. The Company is producing documents in response to the subpoena and intends to fully cooperate with this investigation. At this time, the Company is unable to predict the timing and outcome of this matter.

Northern District of Alabama Investigation

On October 30, 2017, the Company was contacted by the U.S. Attorney's Office for the Northern District of Alabama to request cooperation in connection with an investigation that may involve Medicare billing compliance at certain of the Company's Physiotherapy outpatient rehabilitation clinics. The Company intends to cooperate with this investigation. At this time, the Company is unable to predict the timing and outcome of this matter.

ITEM 1A. RISK FACTORS

The information set forth in this report should be read in conjunction with the risk factors set forth below and the risk factors discussed in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016.

The closing of the acquisition of U.S. HealthWorks by Concentra is subject to the satisfaction of certain conditions, and we cannot predict whether the necessary conditions will be satisfied or waived.

The closing of the acquisition of U.S. HealthWorks by Concentra is subject to regulatory approvals and customary conditions, including, without limitation:

- the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended;
- the accuracy of the representations and warranties in the Purchase Agreement and compliance with the respective covenants of the parties, subject to certain qualifiers;
- the absence of any law or injunction that prohibits the consummation of the acquisition;
- the absence of certain governmental actions; and
- the absence of a material adverse effect on U.S. HealthWorks or Concentra.

The acquisition of U.S. HealthWorks may not close in the anticipated time frame, if at all. The Company has no control over certain conditions in the Purchase Agreement, and cannot predict whether such conditions will be satisfied or waived.

The acquisition of U.S. HealthWorks by Concentra and future acquisitions may use significant resources, may be unsuccessful and could expose us to unforeseen liabilities.

As part of our growth strategy, we may pursue acquisitions of specialty hospitals, outpatient rehabilitation clinics and other related healthcare facilities and services. These acquisitions, including the acquisition of U.S. HealthWorks by Concentra, may involve significant cash expenditures, debt incurrence, additional operating losses and expenses and compliance risks that could have a material adverse effect on our financial condition and results of operations.

We may not be able to successfully integrate U.S. HealthWorks or other acquired businesses into ours, and therefore we may not be able to realize the intended benefits from an acquisition. If we fail to successfully integrate U.S. HealthWorks or other acquisitions, our financial condition and results of operations may be materially adversely affected. The acquisition of U.S. HealthWorks by Concentra and other acquisitions could result in difficulties integrating acquired operations, technologies and personnel into our business. Such difficulties may divert significant financial, operational and managerial resources from our existing operations and make it more difficult to achieve our operating and strategic objectives. We may fail to retain employees or patients acquired through the acquisition of U.S. HealthWorks by Concentra or other acquisitions, which may negatively impact the integration efforts. The acquisition of U.S. HealthWorks by Concentra or other acquisitions could also have a negative impact on our results of operations if it is subsequently determined that goodwill or other acquired intangible assets are impaired, thus resulting in an impairment charge in a future period.

In addition, the acquisition of U.S. HealthWorks by Concentra and other acquisitions involve risks that the acquired businesses will not perform in accordance with expectations; that we may become liable for unforeseen financial or business liabilities of the acquired businesses, including liabilities for failure to comply with healthcare regulations; that the expected synergies associated with acquisitions will not be achieved; and that business judgments concerning the value, strengths and weaknesses of businesses acquired will prove incorrect, which could have an material adverse effect on our financial condition and results of operations.

Our substantial indebtedness may limit the amount of cash flow available to invest in the ongoing needs of our business.

We have a substantial amount of indebtedness. As of September 30, 2017, Select had approximately \$2,177.3 million of total indebtedness, and Concentra had approximately \$613.0 million of total indebtedness, which is nonrecourse to Select. As of September 30, 2017, our total indebtedness was \$2,790.3 million. In connection with the closing of the acquisition of U.S. HealthWorks, Concentra's indebtedness is expected to substantially increase with the addition of a proposed \$555.0 million senior secured incremental term facility under its existing credit facility and a proposed \$240.0 million second lien term facility. Our indebtedness could have important consequences to you. For example, it:

- requires us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, reducing the availability of our cash flow to fund working capital, capital expenditures, development activity, acquisitions, and other general corporate purposes;
- increases our vulnerability to adverse general economic or industry conditions;
- limits our flexibility in planning for, or reacting to, changes in our business or the industries in which we operate;
- makes us more vulnerable to increases in interest rates, as borrowings under our senior secured credit facilities are at variable rates;
- limits our ability to obtain additional financing in the future for working capital or other purposes; and
- places us at a competitive disadvantage compared to our competitors that have less indebtedness.

Any of these consequences could have a material adverse effect on our business, financial condition, results of operations, prospects, and ability to satisfy our obligations under our indebtedness. In addition, there would be a material adverse effect on our business, financial condition, results of operations and cash flows if we were unable to service our indebtedness or obtain additional financing, as needed.

See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Purchases of Equity Securities by the Issuer

Holdings' board of directors has authorized a common stock repurchase program to repurchase up to \$500.0 million worth of shares of its common stock. The program has been extended until December 31, 2018 and will remain in effect until then, unless further extended or earlier terminated by the board of directors. Stock repurchases under this program may be made in the open market or through privately negotiated transactions, and at times and in such amounts as Holdings deems appropriate. Holdings did not repurchase shares during the three months ended September 30, 2017 under the authorized common stock repurchase program.

The following table provides information regarding repurchases of our common stock during the three months ended September 30, 2017. The shares repurchased during the three months ended September 30, 2017 relate entirely to shares of common stock surrendered to us to satisfy tax withholding obligations associated with the vesting of restricted shares issued to employees, pursuant to the provisions of our equity incentive plans.

	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid Per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans or Programs</u>
July 1 - July 31, 2017	—	\$ —	—	\$ 185,249,408
August 1 - August 31, 2017	175,113	17.15	—	185,249,408
September 1 - September 30, 2017	—	—	—	185,249,408
Total	175,113	\$ 17.15	—	\$ 185,249,408

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

<u>Number</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Executive Vice President and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer, and Executive Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial information from the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2017 formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and 2017, (ii) Condensed Consolidated Balance Sheets as of September 30, 2017 and December 31, 2016, (iii) Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2016 and 2017, (iv) Condensed Consolidated Statements of Changes in Equity and Income for the nine months ended September 30, 2017 and (v) Notes to Condensed Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrants have duly caused this Report to be signed on their behalf by the undersigned, thereunto duly authorized.

SELECT MEDICAL CORPORATION

By: /s/ Martin F. Jackson
Martin F. Jackson
Executive Vice President and Chief Financial Officer
(Duly Authorized Officer)

By: /s/ Scott A. Romberger
Scott A. Romberger
Senior Vice President, Chief Accounting Officer and Controller
(Principal Accounting Officer)

Dated: November 2, 2017

SELECT MEDICAL HOLDINGS CORPORATION

By: /s/ Martin F. Jackson
Martin F. Jackson
Executive Vice President and Chief Financial Officer
(Duly Authorized Officer)

By: /s/ Scott A. Romberger
Scott A. Romberger
Senior Vice President, Chief Accounting Officer and Controller
(Principal Accounting Officer)

Dated: November 2, 2017